Petition

81-1340

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No.

IN THE

Supreme Court of the United States

October Term, 1981

F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC.
and
F. D. RICH HOUSING CORP.,

Petitioners,

—*v.*—

GOVERNMENT OF THE VIRGIN ISLANDS,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

Where the respondent raised three new affirmative defenses for the first time during its opening statement at trial:

1. Did the Court of Appeals' decision sanctioning an amendment to assert those defenses render meaningless Federal Rules of Civil Procedure 8(c) and 15 in light of the respondent's lengthy delay and flagrant abuse in this case?

2. Did the courts below err in placing on the petitioner the burden of showing why such an amendment should have been disallowed when the respondent itself was guilty of lengthy, inexcusable, and unexplained delay in asserting its new defenses, which defenses indicated a distinct change in the respondent's theory of the case?

3. Did the Court of Appeals err in sanctioning an abuse of discretion by the district judge, who, without authority and over the respondent's objections, amended the answer *sua sponte* to assert the new defenses and then based his opinion and judgment against the petitioner thereon?

4. Did the Court of Appeals err in affirming the District Court's *sua sponte* amendment asserting defenses that had been waived by the respondent?

PARTIES TO THE PROCEEDINGS BELOW

The parties to the proceedings in the Court of Appeals were F.D. Rich Housing of the Virgin Islands, Inc. and F.D. Rich Housing Corp., the petitioners herein; the Government of the Virgin Islands, the respondent herein; and Heyl & Patterson International, Inc., which the petitioner believes has no interest in the outcome of this petition and has therefore not been named as a party hereto.

DESIGNATION OF CORPORATE RELATIONSHIPS

F.D. Rich Housing of the Virgin Islands, Inc. and F.D. Rich Housing Corp., filing this Petition for a Writ of Certiorari as petitioners in this proceeding, state that:

1. This is their original Designation of Corporate Relationships.

2. F.D. Rich Housing Corp. is a public company which is 82 per cent owned by F. D. Rich Co., Inc. and 18 per cent owned by members of the investing public.

3. F.D. Rich Housing of the Virgin Islands, Inc. is a wholly-owned subsidiary of F.D. Rich Housing Corp.

4. F.D. Rich Housing Corp. does not have an ownership interest in any other subsidiaries (excepting only wholly-owned subsidiaries).

5. F.D. Rich Housing of the Virgin Islands, Inc. does not have an ownership interest in any subsidiaries (excepting only wholly-owned subsidiaries).

6. The affiliates of F.D. Rich Housing Corp. and F.D. Rich Housing of the Virgin Islands, Inc. are the following two limited partnerships: Arbor Hill Partners and Trinity Partners.

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OPINIONS BELOW

The opinion of the Court of Appeals for the Third Circuit, as yet unreported, appears at Appendix A *infra*. The opinion of the District Court of the Virgin Islands, not reported, appears at Appendix B *infra*.

JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was made and entered on October 19, 1981 and appears at Appendix C *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

FEDERAL RULES AND TERRITORIAL STATUTES INVOLVED

Federal Rules of Civil Procedure 8(c), 12(b), and 15(a) are involved in this proceeding, together with the following territorial statutes: 29 V.I.C. § 191n; 33 V.I.C. § 3101; and Act No. 3088, 1971 V.I. Sess. Laws 313, § 1. These provisions are reproduced in Appendix D *infra*.

STATEMENT OF THE CASE

This petition seeks review of a judgment by the United States Court of Appeals for the Third Circuit affirming a decision of the District Court of the Virgin Islands, insofar as that judgment concerns the Government of the Virgin Islands (hereinafter referred to as "the Government"), the defendant and third-party defendant in District Court Civil Action No. 76-62 and No. 75-785 respectively. The petitioners do not seek review of the Third Circuit's judgment insofar as it concerns Heyl & Patterson International, Inc. (hereinafter referred to as "Heyl & Patterson"), the plaintiff in No. 75-785.

The District Court's decision was rendered after a consolidated trial of two actions for breach of contract. (App. A at

A3; App. C). In the first action, brought in December 1975, Heyl & Patterson sued F.D. Rich Housing of the Virgin Islands, Inc. and F.D. Rich Housing Corp. (both hereinafter referred to as "Rich") alleging the breach of an agreement for the construction of moderate-income housing on the island of St. Thomas. (App. A at A4-A7; App. B at B3).

Rich answered the complaint, admitting the contract but denying liability, and asserted a number of affirmative defenses. (App. B at B23). It also brought a third-party action against the Government, alleging that the Government had breached an October 1, 1973 contract with Rich in regard to the planned housing development. (App. A at A7; App. B at B3). The contract, which provided that Rich, as developer, would cause 320 dwelling units to be constructed at a site on St. Thomas known as Estate Nazareth, had been executed by the Government's Commissioner of Housing and Community Renewal, approved by the then-Governor, and further initialed by the Attorney General and Commissioner of the Budget. (App. A at A4; A.A. at 324a).[1] Rich sought indemnification by the Government under that contract for any damages that might be awarded to Heyl & Patterson in the main action. (App. A at A7-A8).

Rich then brought a separate action against the Government seeking damages for breach of the aforesaid agreement. (App. A at A8; App. B at B3). The complaint alleged that the Government had breached its obligations thereunder by failing to establish an escrow fund of $250,000 as required, failing to proceed in a timely manner with site design work, attempting unilaterally to change the previously agreed design of the units, preventing Rich and its contractors from proceeding with their work and, in effect, entirely repudiating the contract with Rich. (A.A. 16a-20a).

The Government answered the complaint, denying liability and asserting two affirmative defenses, neither of which are

[1] "A.A." refers to the Appellants' Appendix in the Court of Appeals. Pursuant to S. Ct. Rule 19.1, Rich has requested the clerk of the court below to transmit to this Court a copy of that portion of the record on appeal.

pertinent to this petition (App. A at A8), together with a counterclaim (A.A. at 27a).

In January 1979, a few months prior to the start of the trial in these consolidated cases, the Government sought leave to amend its answer to assert two new affirmative defenses. (App. A at A8). The proposed Fourth Affirmative Defense, which is the only pleaded defense pertinent to this petition, stated simply, "The agreement dated October 1, 1973, upon which the Plaintiff, F.D. Rich, bases this action is illegal." (A.A. at 39a; *see* App. A at A8; App. B at B6). Rich challenged the proposed amendment on the ground that it failed to specify the nature of the claimed illegality. (App. B at B6; *see* App. A at A8). The Government then filed a reply memorandum, representing to Rich and to the court that its proposed defense meant only that the agreement was illegal because it "involved the expenditure of substantial local revenues for which there was no appropriation and no authority by law" under 33 V.I.C. § 3101. (App. A at A8).

This clarification by the Government of its proposed illegality defense was deemed by the District Court a satisfactory response to Rich's vagueness objection and, on that basis, the court granted leave to amend. (App. A at A8). Six days before commencement of the trial, the Government reaffirmed in its Pretrial Statement that its illegality defense was based solely on the contention that the agreement was unsupported by an adequate appropriation or other authorized funds. (App. A at A8).

On the morning the trial began, however, the Government for the first time raised three new and additional illegality defenses: (1) an alleged failure of the project to comply with the requirement for an approved housing development plan under Act No. 3088, 1971 V.I. Sess. Laws; (2) an alleged failure of the project to meet the cost limitations set forth in 29 V.I.C. § 191n; and (3) an alleged failure of the Department of Housing and Community Renewal to make an authorized transfer of land to Rich. (App. A at A8-A9; App. B at B4, B6).

The Government, however, did not move to amend its answer to assert these new defenses. (App. A at A11). In fact, counsel for the Government denied that she had asserted *any* new defenses at all. (A.A. at 315a). The district judge nevertheless held that simply by raising these three new defenses for the first time in its opening statement, the Government had in effect "move[d] to amend its answer" to allege those matters as affirmative defenses. (App. B at B6; *see* App. A at A11). The court went on to hold that the October 1, 1973 contract was null and void, in that it lacked an adequate appropriation under 33 V.I.C. § 3101 (App. B at B14), failed to comply with the requirement for an approved housing development plan under Act No. 3088, 1971 V.I. Sess. Laws (App. B at B20), and failed to meet the cost limitations set forth in 29 V.I.C. § 191n (App. B at B22). The last two of these three grounds of decision were based on the new defenses raised by the Government for the first time in its opening statement.

On appeal, the Third Circuit agreed with Rich that the District Court had erred in failing to find that both the Commissioner of Housing and the then-Governor were expressly authorized by several Virgin Islands statutes to enter into the October 1, 1973 agreement. (App. A at A18). That fact, standing alone, would under 33 V.I.C. § 3101 have cured completely the so-called "appropriations gap" found by the District Court pursuant to the Government's Fourth Affirmative Defense of "illegality," the only pertinent defense properly raised before trial. The Court of Appeals also agreed that the Government had repudiated its agreement, stating that "the primary reason why the project floundered was not the failures to comply fully with the statutory mandates, but probably because a succeeding governor was not committed to implementing the detailed plan of his predecessor." (App. A at A31). The Third Circuit acknowledged that if the District Court's opinion was upheld, all those who have or contemplate entering into contracts with the Government would have their confidence in those agreements undermined, and that such a result would serve as "merely a pyrrhic victory for the Government." (App. A at A31-A33).

The court nevertheless affirmed the district judge's treatment of the new development plan and cost limitation defenses as valid amendments to the Government's answer. (App. A at A11). It then went on to affirm the District Court's conclusion that the contract was illegal by reason of the failure to comply with the planning and cost limitation statutes. (App. A at A19-A24). As a result, the Government has thus far prevailed against Rich based, in the words of the Court of Appeals, on "a plethora of . . . technical objections." (App. A at A31). Meanwhile, in the face of the Government's repudiation of its own agreement, Rich has been held solely liable to Heyl & Patterson for damages in the amount of $262,398.01, plus $21,000.00 in attorneys' fees and $2,668.25 in costs, together with interest. (App. A at A3).

REASONS FOR GRANTING THE WRIT

This petition raises several important questions that have not been but should be settled by this Court regarding the meaning and limitations of Federal Rule of Civil Procedure 15, as well as the scope of a district court's authority and discretion thereunder.

The grounds for granting motions to amend under Rule 15 are a subject of sharp conflict among the federal courts of appeals. Several of these courts, including the Third Circuit in the instant case, have exercised a liberality of discretion which has in effect made meaningless this provision of the Federal Rules.

In addition, Rich respectfully submits that the District Court has so far departed from the accepted and usual course of judicial proceedings in this matter, and that the Court of Appeals has so far sanctioned that departure, as to call for an exercise of this Court's power of supervision.

1. The Court of Appeals' Decision, If Allowed to Stand, Will Render Meaningless Rules 8(c) and 15.

The only illegality defense properly before the District Court at the start of the trial in this action was that based on a

lack of adequate appropriations or other authorized funds under 33 V.I.C. § 3101. Not until the Government made its opening statement on the morning the trial began did Rich have any reason to believe that there were new "defenses" in the case.[2] The Government's earlier representation to Rich and to the Court regarding the meaning of its proposed Fourth Affirmative Defense amounted to a stipulation that the Government's case would be tried solely on the appropriations issue. "In view of that stipulation [the Government] was not entitled to inject into the case a new theory of [illegality]." *Hargrave* v. *E.G. Wellman,* 276 F.2d 948, 952 (9th Cir. 1960). Rich strenuously objected when counsel for the Government raised several new affirmative defenses for the first time in her opening statement. The District Court held, however, that the Government had in effect "move[d] to amend its answer" to assert the new defenses, and the so-called amendments were allowed.

Federal Rule of Civil Procedure 15(a) instructs that leave to amend "shall be freely given when justice so requires." *Foman* v. *Davis,* 371 U.S. 178 (1962), sets forth the general

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[2] The Court of Appeals misspoke on this point when it stated in its opinion:

> Rich could not have been entirely surprised by the Government's opening statement, because in the Government's Answers to Interrogatories Propounded by Plaintiff of September 26, 1976, the Government, through the Commissioner of Housing, stated that the contract between Rich and the Government was not binding for the reasons later given in the Government's opening statement at trial. (App. A at A13)

Even a cursory examination of the interrogatory response in question (A.A. at 32a) will reveal that this conclusion by the Court is clearly erroneous. The only reference to a possibility of illegality in the interrogatory response was an assertion that the selling price of the Estate Nazareth land to Rich was lower than the acquisition cost of the Government, in alleged violation of 29 V.I.C. § 191n(b). The District Court, however, found that this assertion was untrue, inasmuch as the land had been sold to Rich for approximately the same price as the Government's acquisition cost. (App. B at B22). This issue, arising under subsection (b) of 29 V.I.C. § 191n, bore no relation whatsoever to the *dwelling cost limitations,* found primarily in subsection (a), raised by the Government in its opening statement.

standard to be employed by the federal courts in making a Rule 15(a) determination:

> In the absence of any apparent or declared reason —such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.—the leave sought should, as the rules require, be "freely given."

Id. at 182.

The Third Circuit in the instant case has chosen to ignore the *Foman* decision. The court in effect has removed all of the criteria to be considered in making a Rule 15 determination and has relied on one standard only, "undue prejudice to the opposing party by virtue of allowance of the amendment," as the sole criterion for denying or granting a motion to amend. Even in the face of Rich's claims of undue delay, bad faith, and the failure of the Government to cure deficiencies by amendments previously allowed, the Court of Appeals still insisted that Rich demonstrate prejudice to its satisfaction.[3]

If this Court lets stand the decision of the Third Circuit under the circumstances of this case, the limitations implicit in Rules 8(c) and 15 will be rendered entirely meaningless. Indeed, if leave was appropriately granted on the facts of *this* case, then there is *no* case in which leave could ever be denied again.[4]

This cannot be what the drafters of Rule 15 intended when they provided for the exercise of judicial discretion in con-

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[3] One would have thought that an amendment which seeks to add affirmative defenses and is brought to the attention of the opposing party during a trial creates in itself a presumption of prejudice. Clearly, the legal defenses raised by the Government could have and should have been tested in pretrial proceedings. If in fact the Government's affirmative defenses were correct, Rich could possibly have been spared the cost and expense of a trial in the Virgin Islands.

[4] The Third Circuit itself recognized that the district court's ruling "approach[ed] the maximum latitude of the rules." (App. A at A13).

nection with motions for leave to amend. Nor can it square with the purpose of Rule 8(c), which contemplates that a plaintiff have adequate advance notice of an opponent's affirmative defenses so that it can prepare to meet and hopefully defeat those defenses, perhaps by testing their legal sufficiency before trial. The Court of Appeals' decision, if left undisturbed, will obviate the need for a defendant to plead any defenses at all and will in effect vitiate the policy of Rule 8(c). Rich submits that the Government's sudden, belated, and unexplained introduction of new affirmative defenses of illegality here entitled it to a denial of the so-called motion to amend even without a showing of prejudice. *Matlack, Inc.* v. *Hupp Corp.*, 57 F.R.D. 151, 163 (E.D. Pa. 1972).

The Circuits are sharply divided on the question of whether prejudice must be shown by the non-movant to defeat an amendment even where the other factors enumerated in *Foman* are present. Six Circuits, including the Third Circuit in the instant case, (App. A at A12), insist that prejudice to the non-movant must be shown and is in effect the only ground for denying a motion to amend. *Estes* v. *Kentucky Utilities Co.*, 636 F.2d 1131, 1134 (6th Cir. 1980); *Beeck* v. *Aquaslide 'N' Dive Corp.*, 562 F.2d 537, 540 (8th Cir. 1977); *R.E.B., Inc.* v. *Ralston Purina Co.*, 525 F.2d 749, 751-52 (10th Cir. 1975); *Howey* v. *United States*, 481 F.2d 1187, 1190 (9th Cir. 1973); *see Davis* v. *Piper Aircraft Corp.*, 615 F.2d 606, 613 (4th Cir.), *cert. dismissed pursuant to Rule 53*, 448 U.S. 911 (1980).

The other five Circuits take the view that the various factors mentioned in *Foman* should be considered in the alternative. In these courts, undue delay *or* bad faith *or* repeated failure to cure will dictate denial of an amendment even in the absence of prejudice. *S.S. Silberblatt* v. *East Harlem Pilot Block*, 608 F.2d 28, 42 (2d Cir. 1979); *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1162 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980); *Mertens* v. *Hummell*, 587 F.2d 862, 866 & n.8 (7th Cir. 1978); *Doe* v. *McMillan*, 566 F.2d 713, 720 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 969

(1978); *see Glaros* v. *Perse*, 628 F.2d 679, 686-87 (1st Cir. 1980); *Vargas* v. *McNamara*, 608 F.2d 15, 18 (1st Cir. 1979).

The latter position was obviously the one contemplated by this Court when it issued the *Foman* decision. This was made clear in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321 (1971), where the Court indicated that new defenses could permissibly be rejected as delinquent even in the absence of any prejudice. *Id.* at 329. The same point was emphasized in *Zenith* by the concurring opinion of Justice Harlan, joined by Justice Stewart. Both Justices agreed that it was within a trial judge's sound discretion to reject defenses solely on the ground that they were "too belatedly raised." *Id.* at 349 (Harlan, J., concurring in the result).

The Third Circuit's citation of *Zenith* for the proposition that "undue prejudice 'is the touchstone for the denial of leave to amend'" (App. A at A10) takes that decision's reference to prejudice completely out of context. In the passage cited by the Court of Appeals, 401 U.S. at 330-31, Justice White explained that *even where a movant presented an excuse for its delay*, prejudice to the non-movant would require denial of the amendment. Nowhere did he suggest that prejudice was the *only* basis for rejecting an amendment. On the contrary, and as noted above, the Court indicated that undue delay can justify the denial of an amendment even without prejudice to the non-movant. *Id.* at 329.

The Third Circuit also cited *United States v. Hougham*, 364 U.S. 310 (1960), in support of its decision. In *Hougham*, this Court stated that Rule 15 "was designed to facilitate the amendment of pleadings except where prejudice to the opposing party would result." *Id.* at 316. There, however, the movant had raised its new claims long before trial, continued to raise them through the pretrial stage, and succeeded in having reference to them incorporated in the district court's pretrial order. *Id.* at 315-16. Accordingly, because there was no issue of "undue delay, bad faith or dilatory motive on the part of the movant,...etc.," *Foman v. Davis, supra*, 371 U.S. at 182, the *only*

possible ground on which the denial of an amendment could have been premised in *that* case was prejudice to the opposing party. The Third Circuit in the instant case and five of the other Circuits cited above have since taken the language of *Hougham* and *Zenith* completely out of context to hold that prejudice alone is the sole criterion by which a motion to amend shall be judged. At the same time, they have emasculated the *Foman* decision by ignoring altogether the various other factors enumerated therein.

This petition offers the Court an opportunity to correct this mistaken reading of its Rule 15 cases and to clarify the obvious confusion that prevails in the lower courts on this issue. While Rule 15 prescribes a liberal policy in granting leave to amend, Judge Rifkind has pointed out in a similar case that:

> A liberal policy does not mean the absence of all restraint. Were that the intention, leave of court would not be required. The requirement of judicial approval suggests that there are instances where leave should not be granted. The instant case, I believe, falls into such a category. It is made on the very eve of trial. It proposes to change allegations which go to the heart of the issue without assigning an adequate cause for the modification. It is concerned with matters which, if true, must have been within the defendant's knowledge when the controversy arose.

Schick v. *Finch*, 8 F.R.D. 639, 640 (S.D.N.Y. 1944). *Accord*, *Mertens* v. *Hummell*, *supra*, 587 F.2d at 865.

The considerations outlined in *Schick* are every bit as applicable to this case. The amendments permitted here were based on new defenses raised by the Government after trial had already begun. They went to the heart of the issues and actually cost Rich its recovery. Never did the Government even attempt to justify its belated introduction of these defenses into the case. Yet they concerned matters which were certainly within the Government's knowledge at the earliest indication of controversy.

Moreover, the amendments granted by the District Court here *completely changed the Government's theory of the case*, over Rich's objection, at a moment when Rich was powerless to meet and dispute the new theories adequately. In light of this shift in theory, prejudice as a "touchstone" should have been displaced by other overriding considerations. As the court in *Matlack, Inc.* v. *Hupp Corp., supra*, held:

> [A] shift in theory should be denied, *even in the absence of prejudice*, where the party seeking to interpose it has been guilty of flagrant abuse, bad faith, or truly inordinate and unexplained delay.

57 F.R.D. at 163 (emphasis added). *Accord, Foman* v. *Davis, supra*, 371 U.S. at 182.

If the decisions below are allowed to stand on *these* facts, the Court of Appeals and District Court will have succeeded in altogether nullifying Rules 8(c) and 15. Rich prays that this Court will see fit to correct the errors of the courts below by resolving the split in the Circuits against those courts that use "prejudice" as the sole factor to be considered in determining motions to amend.

2. ***The Courts Below Erred in Placing on the Petitioner the Burden of Showing Why the Amendments Should Have Been Disallowed, When the Respondent Itself Was Guilty of Lengthy, Inexcusable and Unexplained Delay in Asserting its New Defenses and in Distinctly Changing Its Theory of the Case.***

Even if prejudice need be shown, the Government's conduct in this case required it first to justify its delay in asserting new defenses. As Professor Moore has observed, "Where a considerable period of time passes between the filing of the [pleading] and the motion to amend, *courts have placed the burden upon the movant* to show some valid reason for his neglect and delay." 3 *Moore's Federal Practice* ¶ 15.08[4], at 93-94 (Supp. 1980-1981) (emphasis added). *Accord, Vargas* v. *McNamara, supra*, 608 F.2d at 19; *Hayes* v. *New England*

Millwork Distributors, Inc., 602 F.2d 15, 19-20 (1st Cir. 1979); *Freeman* v. *Continental Gin Co.*, 381 F.2d 459, 469 (5th Cir. 1967); *see In re Beef Industry Antitrust Litigation, supra*, 600 F.2d at 1162; *Doe* v. *McMillan, supra*, 566 F.2d at 720; *Goss* v. *Revlon, Inc.*, 548 F.2d 405, 407 (2d Cir. 1976), *cert. denied*, 434 U.S. 968 (1977).

In this action, the Government has yet to explain why it took so long to reveal or "discover" three defenses that later proved central to its case. In addition, the Government's affirmative conduct prior to trial in misleading Rich as to its defense theories surely constituted the sort of flagrant abuse to which the court referred in *Matlack, supra*, and which required that the District Court exercise its discretion by denying the motion to amend. Yet at no time has the Government been required to account for its actions. Instead, both the District Court and Court of Appeals placed on Rich's shoulders the burden of showing why the amendments should have been disallowed.

The Court of Appeals' response to Rich's argument on this point was grossly unfair. "The trial judge," said the court, "did not find that the Government's action rose to the level of deliberate deception or flagrant abuse." (App. A at A13). That he did not so find should come as no surprise, since *he never considered those issues.* In light of the unusual and unexplained passage of time before the Government's new defenses were raised, the District Court should have required the Government to come forward and demonstrate the existence of a legitimate reason for its delay. Only if the Government met that burden would prejudice to Rich have become a relevant issue. *See Foman* v. *Davis, supra*, 371 U.S. at 182. The district court, however, never made any inquiry.

The instant case, therefore, presents this Court with an opportunity to allocate the burden of proof where the special circumstances enumerated in *Foman* v. *Davis, supra*, 371 U.S. at 182; are present. Rich suggests that if lengthy delay goes unexplained, then at the very least an inference of prejudice to the non-movant should arise. *See Mercantile Trust Co.* v.

Inland Marine Products Corp., 542 F.2d 1010, 1013 (8th Cir. 1976); 3 *Moore's Federal Practice* ¶ 15.08[4] n.13, at 15-102 (1980). The burden of going forward should rest upon the movant to demonstrate the absence of bad faith, flagrant abuse, and dilatory motive, as well as the existence of a legitimate excuse for delay. Only then should prejudice become a factor. This Court itself contemplated such an order of proof in the *Zenith* case. 401 U.S. at 330-31.

The evidence in this case demonstrates that both undue delay and flagrant abuse occurred here. Neither of these has ever been explained by the Government. Accordingly, a reversal of the lower court's judgment would be appropriate.

3. The Court of Appeals Erred in Sanctioning an Abuse of Discretion by the District Judge Who, Without Authority, Took the Respondent's Defense Out of Counsel's Hands By Amending the Answer Sua Sponte *Over the Respondent's Own Objections, and Then Based His Decision on His Own Amendments.*

Despite the protestations of counsel for the Government that she had not asserted any new defenses at all, the district judge recognized here that the issues raised by the Government for the first time in its opening statement were in fact new defenses for which amendments to the Government's answer would be necessary. Because the Government itself denied raising new defenses, however, it saw no need to move for leave to amend and did not do so.

The district judge at this point exceeded his authority and thus abused his discretion. By holding that the Government had in effect "move[d] to amend its answer" to assert the new defenses, the judge actually substituted his own legal and tactical judgment for that of the Government's counsel, becoming an advocate for one party over the other. The record is clear that no amendment was sought or intended by the Government. The district judge nevertheless held that a motion had been made. In reality, the motion was the court's own.

The judge then relied on *his* new amendments to find against Rich.

Federal Rule of Civil Procedure 15 instructs the court to grant leave to amend freely "when justice so requires." It does *not* authorize the court to seek such leave on behalf of a party who has affirmatively and decisively rejected that course, *even if the decision of that party's counsel is erroneous.* The Second Circuit has recognized that it is improper for a court to grant leave to amend *sua sponte* under circumstances even less compelling than those of this case. *Walton* v. *Morgan Stanley & Co.*, 623 F.2d 796, 799 n.7 (2d Cir. 1980). Surely, the court's liberal discretion under Rule 15 does not extend so far as to allow it to make motions for a party who has refused the opportunity to make the motion itself.

The Court of Appeals obviously recognized the irregularity of the District Court's action here. It agreed that "formal motion for leave to amend was never made after the trial had begun." (App. A at A11). It further declared that the "trial judge's ruling approach[ed] the maximum latitude of the rules." (App. A at A13). In reality, however, the Court of Appeals stretched the proper meaning of Rule 15 far beyond its "maximum latitude" in a Procrustean effort to affirm the District Court. In doing so, it sanctioned an abuse of discretion by the trial judge, who in effect took the Government's defense out of counsel's hands and chose to manage it himself.

These errors reflect a misunderstanding on the part of both courts below as to the scope of authority given to trial judges by Rule 15. The court possesses broad discretion to decide whether to permit an amendment when motion for leave to amend is properly made. But Rule 15 does not give the court any authority—and neither the Government nor the courts below have cited any authority—that permits a district judge to assume the role of counsel and become an advocate or adversary in a case. Such action is totally alien to our system of justice.

Rich respectfully submits that the Court of Appeals has so far sanctioned this gross departure by the District Court from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. Rich suggests that this Court should settle the question of whether a district judge may act *sua sponte* under Rule 15 when the party on whose behalf he is acting has had the opportunity to do so itself and refused.

4. The Court of Appeals Erred in Affirming the District Court's Sua Sponte *Assertion of New Defenses That Had Been Waived By the Respondent.*

Illegality is an affirmative defense, Fed. R. Civ. P. 8(c), and under Fed. R. Civ. P. 12(b) that defense is ordinarily waived if not presented by motion, answer, or reply. Although Rule 15 gives the trial court discretion to permit an amendment that has not been raised in accordance with Rule 12(b), the district judge abused his discretion here by granting such an amendment *sua sponte* after the Government had waived its alternative defenses under circumstances that led Rich to rely on that waiver.

The Third Circuit sanctioned this error and in so doing departed from established law, as explicated by that court itself in *Systems Inc.* v. *Bridge Electronics Co.*, 335 F.2d 465, 466 (3d Cir. 1964):

> An affirmative defense which is neither pleaded as required by rule 8(c) nor made the subject of an appropriate motion under rule 12(b) is waived . . . . The waiver is final if the defendant fails to correct the omission either prior to trial or during trial, as permitted by rule 15(a)(b) of the Federal Rules of Civil Procedure, 28 U.S.C.A. *Ibid.* The defendant made no application to amend the pleadings or otherwise correct the omission.

Id. at 466 (citations omitted).

The instant case provides this Court with a rare opportunity to establish a standard to guide the lower courts in determining the time after which a waiver of defenses must be

held to have occurred. It also calls for an exercise of this Court's power of supervision over the courts below so as to correct a serious departure from the accepted and usual course of judicial proceedings. Clearly, this Court is called upon to enunciate the standards by which all federal trial judges should be bound. Not to act here will give license to courts below to conduct trials virtually as they see fit and cloak their improper actions in the mantle of judicial "discretion."

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the opinion and judgment of the United States Court of Appeals for the Third Circuit in these proceedings.

Respectfully submitted,

The Petitioners,

F.D. RICH HOUSING OF THE VIRGIN ISLANDS, INC.

and

F.D. RICH HOUSING CORP.

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Appendix

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 80-2749 and 81-1193

HEYL & PATTERSON INTERNATIONAL, INCORPORATED,

Appellee

v.

F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INCORPORATED and F. D. RICH HOUSING CORPORATION,

Appellant

(D.C. Civil No. 75-785)

F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INCORPORATED, as assignee of F. D. Rich Housing of Puerto Rico, Incorporated,

Appellant

v.

GOVERNMENT OF THE VIRGIN ISLANDS,

Appellee

(D.C. Civil No. 76-62)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF THE VIRGIN ISLANDS: DIVISION OF ST. THOMAS

Argued: July 14, 1981

Before: SEITZ, *Chief Judge*, HIGGINBOTHAM and VAN DUSEN, *Circuit Judges*

(Opinion filed October 19, 1981)

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OPINION OF THE COURT

A. LEON HIGGINBOTHAM, JR., *Circuit Judge.*

With flare and kindled hope, on October 1, 1973, the Government of the Virgin Islands signed a contract with a developer to build up to 300 houses "for families of low and moderate income" at Estate Nazareth. The parties stressed that the "need for housing in St. Thomas, Virgin Islands" was so acute that it must be "constructed as expeditiously as possible." Now more than eight years later, instead of having at the site housing for

the poor and those of moderate income, there has been built this extensive law suit, which some would call either a "lawyer's paradise" or a "litigation nightmare." After a gubernatorial election and resulting changes of government administrations, the parties now, instead of laying bricks for housing, are espousing subtle theories of contract, procedural, constitutional, and municipal law while placing the blame on the "other person" in this breach of contract action. There are claims now for hundreds of thousands of dollars because of purported breaches of contract by either the Government and/or the developer. During the eight year interim, not one house has been built pursuant to this contract, not one poor or moderate income person has benefitted by the Government's past expenditures, and in recent years the major project has been an intense legal skirmish in the district courthouse between the developer, the contractor and the Government. Because of the multi-faceted claims, charges and defenses, we are now obligated to sort out esoteric legal doctrines and probably to write with too much detail. Yet, in doing so, we probably thereby mask the tragic consequences which failures of this type cause the intended beneficiaries — families of low and moderate income, for in many ways the latter are the victims of what has been at best a fiasco.

This case involves an appeal from the consolidated trial of two breach of contract actions. In *Heyl & Patterson International, Inc. v. F. D. Rich Housing of the Virgin Islands, Inc., and F. D. Rich Housing Corporation*, Memorandum Opinion, No. 75-785 (D.V.I. May 23, 1980), (hereafter Heyl and Rich), the district court entered judgment in favor of appellee Heyl and against appellant Rich in the amount of $262,398.01, plus costs of $2,668.25, attorney's fees of $21,000.00 and prejudgment interest of $841.50, and dismissed all third party claims by appellant Rich against the Virgin Islands Government. In *F. D. Rich Housing of the Virgin Islands, Inc. as Assignee of F. D. Rich Housing of Puerto Rico v.*

Government of the Virgin Islands, Memorandum Opinion, No. 76-62 (D.V.I. May 23, 1980), (hereafter Rich and The Government), the district court granted judgment in favor of appellee Government and dismissed all claims by appellant Rich against the Government.

Appellant's arguments are clearly not frivolous and appellant has sustained a significant economic loss. Nevertheless appellant has failed to tip the scales sufficiently in its favor to warrant reversal. With some disquietude we will affirm the district court's judgments in both cases.

I.

FACTS

On October 1, 1973, the Government of the Virgin Islands, in pursuit of its goal to provide much needed moderate income housing for the Virgin Islands, entered into a written agreement with appellant Rich for the development and construction of a moderate income housing project (hereafter the Agreement) under Title 29 of the Virgin Islands Code, Public Planning and Development.

The Agreement, executed by the Commissioner of Housing and Community Renewal (hereafter the Commissioner of Housing) and signed by the Governor of the Virgin Islands, Melvin H. Evans, called for the construction, in two phases, of 320 housing units at Estate Nazareth, St. Thomas, Virgin Islands. One hundred units were designated for immediate construction during Phase I. The 220 unit Phase II was scheduled to be under way within two years of the contract date. Each phase was scheduled for completion two years after the start of construction. The Government was to sell the land at Estate Nazareth to Rich for $7,000 per acre, including the cost of stipulated site improvements. Site improvements were specified as all work more than five feet from the exterior of constructed units, including but

not limited to sewers, paved roads, parking areas, grading, walks, lighting, electrical service, drainage, and sewer systems.

The selling price of two-bedroom units was set at $22,050.00, three-bedroom units at $23,525.00 and four-bedroom units at $25,200.00. To secure its obligation to buy unsold units, the Government agreed to set up a $250,000.00 escrow fund for purchasing such units and making site improvements. The $92,400.00 which Rich agreed to pay for the land at Estate Nazareth also was to be deposited in this fund. An escrow fund, however, was never actually established by the Government.

Quit claim deeds for Estate Nazareth were delivered by the Government to Rich on August 21, 1974. Rich received a Notice to Proceed with Phase I from the Commissioner of Housing on August 22, 1974. Thereafter, on August 28, 1974 Rich engaged Heyl to act as general contractor for Phase I of the proposed development. The agreement between Heyl and Rich required Heyl to "substantially complete" all work within one year of receiving a Notice to Proceed from Rich. If Heyl failed to do so liquidated damages of $150.00 per day were to be paid by Heyl to Rich.

Rich's contractual obligation required it to pay Heyl monthly progress payments which were set at ninety per cent of the contract sums allocable monthly to labor and materials and equipment used and in storage. Payments were contingent upon Rich receiving certificates of payment from the project architect after he had approved Heyl's applications for payment. Heyl began billing Rich in November, 1974 and by April 30, 1975 had billed Rich for $270,848.31. No payments in fact were ever made by Rich to Heyl.

Several weeks after concluding its agreement with Rich, Heyl received Notice to Proceed as of September 20, 1974. Although Heyl assembled labor, equipment and materials to begin work on the project, construction could not proceed because the requisite building permit

was not issued by the Government. The Virgin Islands Planning Office cited insufficient design information as its reason for rejecting efforts by Rich and subsequently Heyl to obtain the permit.

In December, 1974 Rich agreed to delay Heyl's "proceed date" until January 6, 1975, and received from the Government an indefinite extension of its own proceed date until a building permit was issued. Rich then notified Heyl that the Government's delay in processing the building permit was affecting its financial arrangements and causing a delay in its processing of contract payments. Despite approval of the housing development plan by the Virgin Islands Planning Office on January 2, 1975, and its recommendation that a building permit be issued, the permit remained unissued. Citing unresolved questions about Government funding for project improvements, the Commissioner of Public Works informed Heyl in a letter dated April, 1975 that no permit could be issued.

Meetings in April and August, 1975 between Rich and the Government, including then Governor Cyril King, who, in January, 1975, had succeeded Governor Evans in office, failed to move forward what until then, with the exception of $50,000.00 advanced by the Department of Housing to the Department of Public Works for preliminary road construction, was largely a "paper" project. Realization of the project became even more unsure when Governor King objected to certain design features of the units, the density of the project and a number of contract provisions which he thought unfairly burdened the Government. In September, 1975, the Government of Cyril King disavowed responsibility for "alleged 'unobserved' agreements consummated years prior to assuming office."[1] Shortly thereafter Heyl, hav-

1. Letter of September 2, 1975 from Peter deZela, Executive Assistant to Governor, to Irvin J. Silver, Vice-President, F. D. Rich Housing Corporation. The concluding paragraph of Mr. deZela's letter stated in full that:

ing received no payments on its contract, brought suit against Rich in district court for breach of contract. Rich followed by asserting third party claims and a separate breach of contract action against the Government.

II.

RICH v. THE GOVERNMENT

Because it was Rich's 1973 agreement with the Government which precipitated both actions, we begin with Rich's claims against the Government rather than Heyl's breach of contract action against Rich.

A. *The Pleadings Maze*

At the outset we are confronted with a strenuously pressed procedural objection that either the Government did not move to amend its answer to assert the defenses on which it ultimately won below, or that it was an abuse of discretion by the trial court to allow belatedly the challenged amendments. The pleading style and trial tactics of the Government were not a model of expedition and clarity, but apparently the trial judge grasped the issues and the appellant should have as well. Nevertheless we must trace the maze through which the pleadings flowed to reach the final judgment.

Heyl initiated a breach of contract action against Rich in December, 1975. Rich responded by asserting a third party claim against the Virgin Islands Government

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In closing, I would like to re-emphasize that this new Administration should not be held fully responsible for alleged "unobserved" agreements consummated years prior to assuming office, that the present financial position of the government may now present an insuperable obstacle in resolving the various problems attending the proposed housing project, and that F.D. Rich itself appears to have failed to observe a number of provisions of the 1973 contract.

for indemnification for any liability it might have to Heyl and in a separate action sued the Government for breach of contract. In answer to appellant's claim the Government pleaded two affirmative defenses, neither of which alleged any illegality in the agreement between Rich and the Government. *Three years later* in January, 1979, the Government sought leave to amend its answer pursuant to Fed. R. Civ. P. 15(a), in order to assert a third affirmative defense alleging that the Agreement was void and unenforceable[2] and a fourth defense alleging its illegality.Rich agreed to withhold any objections to the Government's motion to amend if the court in granting leave to amend required the Government to clarify in detail the basis of its new defenses. The Government's response to Rich stated that the Agreement was illegal because it "involved the expenditure of substantial local revenues for which there was no appropriation and no authority by law," in violation of V.I. Code Ann. tit. 33 §3101.

In his Memorandum and Order of March 6, 1979, the district court judge denied the Government's Motion for Summary Judgment, but granted it leave to amend its answer. The Government's clarification of its illegality defense was deemed by the court a satisfactory response to Rich's vagueness objection.

Although in its Pretrial Statement the Government alleged only that the Agreement was void and unenforceable "inasmuch as it was not authorized by law and an appropriation adequate to its fulfillment was never made," in its opening statement at trial it specified three additional illegality defenses: (1) failure of the project to comply with the requirement of Act No. 3088, V.I. Sess.

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2. The Government's third affirmative defense alleging that the Agreement was unenforceable because the contract was illusory and lacked mutuality is not at issue in this appeal. The district court found the Agreement was not void and unenforceable for lack of consideration. Mem. op. at 3.

Laws 1971 for an approved housing development plan; (2) failure of the project to meet the cost limitations set forth in V.I. Code Ann. tit. 29 §191n; and (3) failure of the Department of Housing and Urban Renewal to make an authorized transfer of land to Rich.[4]

Appellant argues that the Government waived all illegality defenses except inadequate prior appropriations which was specifically pleaded in response to Rich's objections about the vagueness of the Government's illegality defense. Rich also argues that when the court permitted the Government to amend and then clarify its Fourth Affirmative Defense, no other illegality defenses could be pleaded and that absent a request for further leave to amend, the court improperly treated the Government's opening statement on defenses as amendments to the answer.

B. *The Standard for Amendment*

Leave to amend pleadings out of time under Rule 15(a) of the Federal Rules of Civil Procedure is generally at the discretion of the trial court, *Foman v. Davis*, 371 U.S. 178, 182 (1962). *Zenith Radio Corporation v. Hazeltine Research, Inc.*, 401 U.S. 321, 330 (1971), and "[c]ourts have shown a strong liberality . . . in allowing amendments under Rule 15(a)." 3 Moore's Federal Practice ¶15.08(2) at 15-59 (2d ed. 1980), (footnote omitted), which specifically states that leave to amend "shall be freely given when justice so requires."

In *Foman v. Davis* the Supreme Court observed:

> Rule 15(a) declares that leave to amend "shall be freely given when justice so requires"; this mandate is to be heeded. If the underlying facts or circumstances relied upon by a plaintiff may be a prop-

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3. The district court's finding that an authorized transfer of land to Rich had taken place is unchallenged and not at issue in this appeal.

> er subject of relief, he ought to be afforded an opportunity to test his claim on the merits. In the absence of any apparent or declared reason — such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. — the leave sought should, as the rules require, be "freely given." Of course, the grant or denial of an opportunity to amend is within the discretion of the District Court, but outright refusal to grant the leave without any justifying reason appearing for the denial is not an exercise of discretion; it is merely abuse of that discretion and inconsistent with the spirit of the Federal Rules.

Id. at 182. *Accord, U.S. v. Hougham*, 364 U.S. 310 (1960); *S. S. Silberblatt, Inc. v. East Harlem Pilot Block*, 608 F.2d 28 (2d Cir. 1979); *Skehan v. Trustees of Bloomsburg State College*, 590 F.2d 470 (3d Cir. 1978), *cert. denied*, 444 U.S. 832 (1979); *Cornell and Company, Inc. v. Occupational Safety and Health Review Commission*, 573 F.2d 820 (3d Cir. 1978); *Thomas v. E. I. DuPont de Nemours & Co.*, 574 F. 2d 1324 (5th Cir. 1978); *Mertens v. Hummell*, 587 F.2d 862 (7th Cir. 1978); *Bireline v. Seagondollar*, 567 F.2d 260 (4th Cir. 1977).

The trial court's discretion under Rule 15, however, must be tempered by considerations of prejudice to the non-moving party, for undue prejudice is "the touchstone for the denial of leave to amend." *Cornell*, 573 F.2d at 823. *Accord, Foman* 371 U.S. at 182; *Zenith Radio Corp.*, 401 U.S. at 330-31; *Skehan*, 590 F.2d at 492. *See also*, 3 Moore's Federal Practice, ¶15.08[4] at 15-85 to 91. In the absence of substantial or undue prejudice, denial must be grounded in bad faith or dilatory motives, truly undue or unexplained delay, repeated failure to

cure deficiency by amendments previously allowed or futility of amendment. *Foman*, 371 U.S. at 182. *See also, Goodman v. Mead Johnson & Co.*, 534 F.2d 566 (3d Cir. 1976), *cert. denied*, 429 U.S. 1038 (1977); *Mertens v. Hummel*, 587 F.2d 862 (7th Cir. 1978); *Matlack, Inc. v. Hupp Corporation*, 57 F.R.D. 151 (E.D.Pa. 1973); 3 Moore's Federal Practice ¶15.08[4] at 15-91 to 100. The decision of the trial court to grant or deny leave to amend is not subject to reversal except for abuse of discretion. *Foman*, 371 U.S. at 182; *Zenith Radio Corp.* 401 U.S. at 330-31; *Cornell*, 573 F.2d at 823; *Canister Co. v. Leahy*, 191 F.2d 255, 257 (3d Cir. 1951), *cert. denied*, 342 U.S. 893 (1951).

Although formal motion for leave to amend was never made after the trial had begun, the trial court's treatment of the Government's opening statement on their defenses as further amendments to the pleadings does not constitute reversible error.[4] The procedure for obtaining leave to amend pleadings set forth in Rule 8 of the Fed. R. Civ. P. should generally be heeded, but rigid adherence to formalities and technicalities must give way before the policies underlying Rule 15. "[T]he federal rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits," *Conley v. Gibson*, 355 U.S. 41, 48 (1957).

Appellant's abuse of discretion claim is grounded in its assertion that prior to trial the Government was granted a conditional leave to amend and thus waived the

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4. *Cf.*, Sherman v. Hallbauer, 455 F.2d 1236 (5th Cir. 1972) in which the appellate court in reversing the trial court's grant of summary judgment stated that plaintiff's motion in opposition to summary judgment should have been construed as a motion to amend the pleadings. The substance of plaintiff's motion represented a change in legal theory which provided, the court said, sound support for plaintiff's case and militated against summary judgment.

right to plead further defenses. We agree with the district court's conclusion, however, that in its Memorandum and Order of March 6, 1979 granting the Government leave to amend, there was no preclusion from further amendments.[5]

Appellant claims that there was no justification proffered for the delay in making the amendments and further that the pleadings were deliberately misleading. Appellant seems to suggest that such conduct constitutes reversible error because it is prejudice *per se*. However, appellant has a heavier burden than merely claiming prejudice, it must show that it was unfairly disadvantaged or deprived of the opportunity to present facts or evidence which it would have offered had the Government's amendments been timely. *Deakyne v. Commissioners of Lewes*, 416 F.2d 290, 300 n.19 (3d Cir. 1969).

Though Rich argues that the opening statement of the Government constituted an unexpected change in

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5. The court's Memorandum and Order addressed both the Government's Motion for Leave to Amend its answer and its Motion for Summary Judgment, but it is the former which concerns us here. The court's comments on the amendments follow:

> The Government seeks to amend its complaint by adding an admission, to which no party objects, and by inserting third and fourth affirmative defenses. F. D. Rich has no objection to the amendments other than a concern that the defenses are stated in a vague manner. In the Government's Memorandum in support of Motion for Summary Judgment and its Reply to F. D. Rich's Response for Leave to Amend Answer, the vagueness noted by F. D. Rich has been cured. Although not directly affected by the amendments, Hevl also objects to them on the basis that they are likely to delay the upcoming trial. Hevl's fear is misplaced, however, since the amendments address solely legal issues and require minimal additional trial preparation. Thus, there is no reason for disallowing the Government's request for leave to amend.

Mem. and Order of March 6, 1979 at 2.

theory which Rich, because of time restraints, was unable effectively to meet during trial, Rich failed either to seek a continuance to enable it to offer such rebuttal evidence or to present such evidence of prejudice in post-trial briefing. Even to this hour appellant has not indicated what evidence it would have presented in view of the Government's alleged change in theory. Furthermore, Rich could not have been entirely surprised by the Government's opening statement, because in the Government's Answer to Interrogatories Propounded by Plaintiff of September 29, 1976, the Government, through the Commissioner of Housing, stated that the contract between Rich and the Government was not binding for the reasons later given in the Government's opening statement at trial.

While the niceties of precise, timely and unambiguous pleadings are preferable, we must note that trial judges are somewhat like quarterbacks in that they have a broad range of options for their game plan, and the losing party is not entitled to a new trial even when the trial judge's ruling approaches the maximum latitude of the rules. Since the trial judge did not find that the Government's action rose to the level of deliberate deception or flagrant abuse and there was no prejudice proven, we do not believe on this record that the trial judge committed an abuse of discretion in allowing the amendments.

C. *The Validity of the Agreement*

On a substantive level, several issues were raised challenging or supporting the validity of the October 1, 1973 agreement. In short, the Government claims the Agreement was invalid because: (1) the Agreement was not supported by adequate prior appropriations and thus violated V.I. Code Ann. tit. 33 §3101; (2) a government-approved housing development plan, required by Act 3088, 1971 V.I. Sess. Laws, was not obtained; and (3)

the agreement violated moderate income housing cost limitations established by V.I. Code Ann. tit. 29 §191n.

Appellant claims that the Agreement was valid and enforceable because: (1) there was no appropriations gap, and even if there were, it did not render the Agreement void *ab initio*; (2) the Agreement was "authorized by law" and thus enforceable under both V.I. Code Ann. tit. 33 §3101 and V.I.Code Ann. tit. 31 §248; (3) legislative approval of a housing development plan was not required for this Agreement and (4) moderate income housing cost limitations established by V.I.Code Ann. tit. 29 §191n are inapplicable to the development at Estate Nazareth.

1. *The Appropriations Gap*

Anyone who manages a budget recognizes the possible nightmare when expenditures significantly exceed income. Such problems could be particularly disastrous if governmental officials could obligate their government when the legislature had not appropriated the prerequisite funds. To prevent such calamities, at least since 1870 there has been a federal statute which makes it unlawful "for any department of the [federal] government to spend in any one fiscal year any sum in excess of appropriations made by Congress for that fiscal year, or to involve the government in any contract for the future payment of money in excess of such appropriations." 16 Stat. 251 (July 12, 1870). Since 1870 the original federal statute has had several modifications but, with few exceptions, officers or employees of the United States have been prohibited from making expenditures or contract obligations in excess of appropriated funds. In 1957 the Legislature of the Virgin Islands adopted verbatim the federal statute as embodied in 31 U.S.C. §665. *See* V.I. Code Ann. tit. 33 §3101. In reliance on this statute the Government raised its first illegality defense — that in substance the agreement of 1973 was a nullity because it attempted to commit the Government of the Virgin Is-

lands to financial obligations in excess of any funds appropriated.

Despite all of the fanfare of initiating a project to build housing for the poor and those of moderate income, despite the expenditure of at least $50,000 in government appropriations, despite the authorization of $950,000 for this project, despite the fact that preliminary road construction was started, despite the fact that there was testimony that in excess of $500,000 had already been expended on the project, Rich lost its entire case on the basis of a mathematical calculation that there was a $150,000 shortfall in the total appropriations. According to the trial judge $1.1 million was necessary for the site work required under the contract[6] and by his calculation only $950,000[7] was appropriated.

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6. Rich objects to this figure only insofar as it includes site improvements for the entire 320-unit Nazareth project. Rich argues that since only 100 units were scheduled to be built in Phase I, the $1.1 million figure should be reduced proportionately. Although there is an equitable appeal to appellant's assertion, it is not sufficiently meritorious to counter the fact that upon signing the Agreement on October 1, 1973, the Government became obligated to make site improvements for the entire project. This was not obviated by the fact that the project was to be done in a minimum of two phases. Furthermore, appellant's claim was not supported by evidence of an alternative estimate of the Government's site cost obligation. Consequently, we cannot find that the trial court's $1.1 million estimate of the Government's liability was clearly erroneous.

7. Seven hundred fifty thousand dollars ($750,000) was appropriated by the Legislature in 1971 for "the construction of roads and site improvements, Estate Nazareth, including recreational facilities," with the specific proviso that the funds "remain available until expended for the projects and purposes hereinafter expressly named." 1971 V.I. Sess. Laws Act No. 3054. The district court correctly concluded that because of the Act's proviso language, the $750,000 could be expended beyond its year of appropriation under V.I. Code Ann. tit. 33 §3111 which states that an appropriation does not automatically expire at the end of the fiscal year if otherwise provided by law. On July 2, 1973, $200,000 in additional funding was appropriated. 1973 V.I. Sess. Laws Act 3445. Thus a total of $950,000 was specifically appropriated by the Legislature for the Nazareth development.

Thus the major issue for our review is whether, as of October 1973, the Legislature had appropriated sufficient funds for the cost of these site improvements or whether there was a shortfall of such a magnitude to make the original agreement null and void *ab initio*.

The relevant statutes on adequacy of appropriations provide:

> *Expenditures or contracts in excess of appropriations.*
>
> No officer or employee of the Virgin Islands shall make or authorize an expenditure from, or create or authorize an obligation under, any appropriation or fund in excess of the amount available therein; nor shall any such officer or employee involve the government in any contract or obligation for the payment of money for any purpose, in advance of appropriations made for such purpose, unless such contract or obligation is authorized by law.

V.I. Code Ann. tit. 33 §3101.

> *Unauthorized purchases.*
>
> No contract or purchase on behalf of the government shall be made unless the same is authorized by law or is under an appropriation adequate to its fulfillment.

V.I. Code Ann. tit. 31 §248.

> *Violations; recovery of funds.*
>
> (a) Any purchase order or contract executed in violation of this chapter and of the rules and regulations promulgated for its enforcement, shall be null and ineffective and, if public funds have been expended in relation therewith, the amount so expended may be recovered in behalf of the Government of the Virgin Islands through proper action instituted for such purpose.

V.I. Code Ann. tit. 31 §249.

Our reading of V.I. Code Ann. tit. 33 §3101 and V.I. Code Ann. tit. 31 §§248 and 249 and the limited number of cases dealing therewith leads us to affirm the district court's conclusion that inadequate prior appropriations made Rich's agreement with the Government void and unenforceable. We do so after careful consideration of the disjunctive language of both §248 and §3101. Although aware of the equitable claims on both sides, we believe the trial court's finding of an appropriations gap of $150,000 is supported by the record. The meaning of this "gap," however, must be considered more closely.

In *Sargeant v. Government of the Virgin Islands*, 10 V.I. 245 (D.V.I. 1973) authored by the trial judge in this case, Chief Judge Christian, a contract executed without adequate prior legislative appropriations in violation of V.I. Code Ann. tit. 31 §248 and V.I. Code Ann. tit. 33 §3101 was held void and unenforceable under V.I. Code Ann. tit. 31 §249. Although three legislative resolutions had been passed authorizing and approving the building project at issue in *Sargeant*, they were held not sufficient to overcome the statutory command of §§248 and 3101 that no contracts be executed except in conformity with legislative appropriation of funds. Because no formal legislative appropriation had been made, plaintiff was limited to those funds advanced by the federal government for architectural fees. So far as local funds were concerned, plaintiff was denied recovery.

Appellant's position, however, is distinguishable from that of plaintiff in *Sargeant*. Plaintiff's contract in *Sargeant* was supported by legislative resolutions only, which the court held were not equivalent to formal legislative appropriations. *Sargeant*, 10 V.I. at 248. Here formal legislative appropriations totaling $950,000 were made in support of Rich's agreement with the Government. But because appropriations were inadequate Rich had the burden of showing that its Agreement was authorized by law in compliance with the alternative mandate of §§248 and 3101 that absent conformity with leg-

islative appropriations, a contract with the Government must be authorized by law to be valid. *See generally, Sargeant*, 10 V.I. 245.

2. *"Authorized By Law"*

We agree with appellant's contention that both the Commissioner of Housing and the Governor had express authority to enter into a contract with Rich under V.I. Code Ann. tit. 29 §191 d(a)(6).[8] The Governor is similarly authorized by V.I. Code Ann. tit. 29 §192, ("Acceleration and expansion of housing and homestead programs,"), "to make and execute contracts and other instruments necessary or convenient to the exercise of the powers conferred by this section," V. I. Code Ann. tit. 29 §192(b)(7), which includes authority to: study and determine the housing needs of the Virgin Islands, V.I. Code Ann. tit. 29 §192(b)(1); carry out programs and projects in accordance with such determinations, V.I. Code Ann. tit. 29 §192(b)(2); and arrange or contract for "services, privileges, works, utilities or facilities" required by an authorized home construction project. V.I. Code Ann. tit. 29 §192(b)(3).

But a finding that both officials were expressly authorized to make the contract does not mean the Agreement was "authorized by law" under §§248 and 3101.

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8. The relevant provisions of V.I. Code Ann. tit. 29 provide:

§191d. *Powers and duties of the Commissioner.*

(a) In addition to any other powers conferred upon him by this subchapter or any other provisions of law, the Commissioner, with the approval of the Governor, and on behalf of the Government of the Virgin Islands, may:

(6) *enter into contracts in accordance with procedures set forth by law, and formalize and execute all instruments necessary or advisable in the exercise of the powers granted to him* or the Government in carrying out the purposes of this subchapter;

(emphasis added).

To meet this standard, the Agreement must have been executed not only "in accordance with procedures set forth by law," V.I. Code Ann. tit. 29 §191d (a)(6), but also must be in accordance with other statutory requirements. We affirm the district court's finding that the Agreement was "unauthorized by law" because it failed to comply with the housing development plan requirement of Act 3088, 1971 V.I. Sess. Laws and the cost limitations of V.I. Code Ann. tit. 29 §191n.

3. *The Housing Development Plan Requirement*

As an alternative basis for his holding that the 1973 agreement was invalid, the trial court concluded that Rich's agreement with the Government also failed to comply with Act 3088, 1971 V.I. Sess. Laws at 313-14.[9] For our purpose the key issue on review as to this statute, is what is the meaning of the terms "prior" and "government sponsored" housing projects. The literal language of the statute requires that government-sponsored housing projects receive the approval of both the governor and the Legislature by their adoption of a

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9. Act 3088, 1971 V.I. Sess. Laws at 313-14 states:

To Require the Adoption of a Comprehensive Housing Development Plan Prior to the Construction of Government-Sponsored Housing Projects and for other purposes

Be it enacted by the Legislature of the Virgin Islands:

SECTION 1. Notwithstanding any other general or specific law to the contrary, no housing project, housing development or housing unit shall be constructed under the jurisdiction of the Department of Housing and Community Renewal or the Virgin Islands Housing Authority unless a "housing development plan" therefor is first adopted and submitted to the Governor and the Legislature for approval. The housing development plan required by this Act shall be a statement by words, maps graphics and other appropriate forms of the overall proposed housing project.

"housing development plan" if the project is constructed under the jurisdiction of the Department of Housing and Community Renewal or the Virgin Islands Housing Authority. Rich does not contend that they had received any legislative approval or adoption of the housing plan when they executed the 1973 agreement. Instead, Rich asserts that the statute was not applicable to the Estate Nazareth development because it was not a "government sponsored housing project."

We disagree and adopt the well-reasoned findings of the district court. As the court noted, "Government-Sponsored Housing," absent legislative intent showing otherwise, surely means not just housing actually built by the Government. The Government's extensive involvement in the building of Estate Nazareth belies any contention that the development was purely a private endeavor. Aside from its responsibility for making site improvements, the Government was obligated under the Agreement to designate purchasers for each unit, arrange mortgage financing for purchasers, and purchase all unsold units. Furthermore the Government was to seek federal funding from the Department of Housing and Urban Development and assist Rich in obtaining construction financing. We believe that involvement of the Government on this level brought the Nazareth development under the jurisdiction of the Department of Housing and Community Renewal.

Appellant urges us to hold that the provisions of Act 3088, requiring legislative adoption and approval, do not apply as a condition precedent to the execution of the contract. Rather appellant asserts that this provision becomes operative only when the actual construction of the housing units is about to take place. We must note that neither the position of the appellant nor the appellee is frivolous, but here we are required to construe an important statute without any revelation of its legislative history; thus, in this context the comments of our colleague, Judge Garth, are particularly relevant:

> When defining specific terms in a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute . . . and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature.

Marsh v. Government of the Virgin Islands, 431 F.Supp. 800, 804 (D.V.I. 1977)(Garth, Circuit Judge, sitting by designation).

We suspect that the Virgin Islands Legislature did not intend for Act 3088 to have the limited impact asserted by appellant; we therefore agree with the district court's rejection of such a rigid interpretation. To decide as Rich contends, the seeming "objects and policy of the law" would be repudiated. For under Rich's rationale, contracts executed prior to the approval of a housing development plan would nevertheless obligate the Government to go forward with that housing development even if it did not fulfill the goals and purposes of the Government to provide quality moderate income housing.

4. *Statutory Cost Limitations*

As another alternative ground the trial judge held that the Agreement was "illegal and unenforceable" because it exceeded the $25,000 cost limitations of V.I. Code Ann. tit. 29 §191n. V.I. Code Ann. tit. 29 §191n states:

> Cost Limitations
>
> (a) No dwelling shall be erected by the Government at a cost of more than $25,000 exclusive of the proportional cost of the land.
>
> (b) The minimum selling price for a dwelling shall be a sum at least equal to the Government's acquisition cost plus the cost of any additions and improvements.

Rich would have us interpret §191n to include only housing actually built by the Government and not that built by a private developer for the Government. We decline to do so and find that the trial court did not err in concluding that "erected by the Government" is to be broadly interpreted to embrace housing built by private developers in circumstances such as those presented by this case, especially since the Agreement itself states that Rich's contract with the Government "relates to a Moderate Income Housing Project as defined in Title 29."[10] The Legislature set $25,000 as the maximum selling price apparently because it believed that price would assure that moderately priced housing was built. To except out housing built for the Government by private developers would undermine the intent and purposes of the moderate income housing program.[11]

Appellant's reliance on cases interpreting the Capehart Act, 70 Stat. 635, ch. 783, §§101-104, 109(b), 111, 401-409 (1955) (codified at 12 U.S.C. §§1748-1748g and 42 U.S.C. §§1594-1594f),[12] is misplaced. In

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10. In 1974 the applicability of §191n to Rich's agreement with the Government was considered. Responding to the Commissioner of Housing's inquiry about passing increased costs on to prospective homeowners, the Attorney General of the Virgin Islands stated that under V.I. Code Ann. tit. 29 §191n(b) prospective homeowners would be required to absorb the difference between their stated contract price and the Government's costs. Appellant's contract with the Government contained an escalator clause based on the cost of living index, but no comparable clause appeared in the contracts of prospective homeowners. Because Section 6 of homeowners' contracts expressly incorporated by reference Title 29, however, the Attorney General concluded that 191n(b) governed. 7 V.I. Op. A.G. 332 (1974).

11. *See* V.I. Code Ann. tit. 29 §191(a)(1)-(6), §191(b).

12. The purpose of the Capehart Act, which had its inception in Title IV of the Housing Amendments of 1955, 69 Stat. 646, was to provide adequate and inexpensive military housing near military installations. The Secretary of Defense was authorized to enter into contracts for such housing with eligible contractors and given broad authority with respect to funds appropriated under the Act. Federal

Anthony P. Miller, Inc. v. United States, 348 F.2d 475 (Ct.Cl. 1965) the Government contractor was permitted to recover additional compensation for costs incurred in repairing housing units damaged as a result of defective Government plans even though this increased the costs above the mortgage limit set under the Act. He was not permitted to recover for extra work not called for in the contract which would have pushed costs beyond the mortgage limit. Rich's position is clearly distinguishable from that of the contractor in *Anthony P. Miller*. The cost overruns in the latter case were not negotiated into the contractor's initial agreement with the Government in violation of the statutory ceiling. The illegal cost overrun in the case of appellant, however, was inherent in appellant's contract.

The trial court concludes that under §191n(a) only the proportional cost of land can be deducted from the cost of each dwelling. We find no authority for the Commissioner of Housing to ignore the costs of the improvements by including them in the cost of land. In *Centex Construction Corp. v. United States*, 162 Ct.Cl. 211 (1963), another Capehart Act case relied upon by appellant, the Secretary of Defense had express authority to use his discretion to determine whether to allocate the cost of utilities and improvements to housing contract mortgages or to appropriated funds. He did not have authority to ignore those costs, exceed the $16,500 mortgage limit set by the Act or pay costs greater than appropriated funds. The $7,000 per acre which Rich paid for the land, testimony showed, was the cost of the land to the Government, absent consideration of site improvement costs. If we were to accept appellant's reasoning, the Government would be left to absorb the total

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mortgage insurance was made available for financing, but a mortgage ceiling of $16,500 was set, limiting the cost per unit to that amount.

cost of site improvements, which in this case would exceed $1 million. For the same reason we conclude that the trial court correctly determined that Rich's agreement violated §191n(b): the minimum selling price of $22,050.00 set by the Agreement, because it did not include the Government's $11,000 costs for site improvements, was illegal.

D. *Appellant's Right of Recovery*

Appellant argues that neither inadequate prior appropriations, nor the lack of a Government-approved housing plan, nor the failure of the Agreement to conform to statutory cost limitations should defeat Rich's right to payment to the extent of appropriated funds. We conclude, however, that because the Agreement did not meet statutory requirements it was null and void *ab initio* and under the proscription of §249 cannot be enforced on a theory of *quantum meruit*, substantial compliance or estoppel. *Government of the Virgin Islands v. Ottley*, Nos. 3-1970, 285-1970, and 58-1970 (D.V.I. March 7, 1972); *Sargeant*, 10 V.I. at 252-53.

In *Government v. Ottley* contractors were barred under Section 249 from asserting a defense of estoppel or *quantum meruit* when the Government sought recovery of funds expended in violation of statutory bidding procedures. Relying on *Ottley*, the district court in *Sargeant*, denied recovery, in so far as local funds were concerned, on a theory of *quantum meruit* or estoppel when the Government contract was executed in violation of V.I. Code Ann. tit. 31 §3101. The reasoning of the court in both cases bears repeating: If contracts violative of statutory prohibitions may be executed by government agencies and subsequently enforced, the power of the legislature and the processes of government itself would be undermined. *See Sargeant*, 10 V.I. at 252, citing *Government of the Virgin Islands v. Ottley*, Mem. op. at 3.

Appellant cites numerous cases in support of its proposition that recovery should be permitted at least to the extent of appropriations.[13] But none of the cases relied upon by appellant involved recovery on a contract not made in accordance with law. Recovery was permitted for cost overruns or in spite of inadequate governmental appropriations, but not in the face of an invalid contract. The invalidity of appellant's Agreement bars recovery on any basis.

> It is the general rule that where a bargain is either partially or wholly illegal, not even a quasi-contractual recovery can be had. (footnote omitted.)
>
> This rule is strictly enforced against those entering into bargains with public bodies where the mode of contracting is limited and defined by constitution, statute, ordinance, or appropriate administrative regulation. (footnote omitted.)
>
> Where such restriction or limitation is not observed, the law will not raise a constructive contractual obligation although the public body has received the entire performance, since so to do would nullify in effect the restriction or limitation.
>
> Nor can an agreement with a municipality, absolutely void for non-conformity with statutory re-

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13. *See e.g.*, Reeder v. United States, 1 Ct.Cl. 141 (1844) (recovery on a claim for compensation permitted where Secretary of Navy authorized to appoint three persons to do required work even though the $6,000 appropriation was exceeded); Fowler v. United States, 3 Ct.Cl. 43, 48 (1867) (recovery permitted on a contract for enlargement of Library of Congress even though the contract exceeded the appropriated amount where an Act of Congress specifically authorized the enlargement); Sutton v. United States, 256 U.S. 575, 581 (1921) (recovery of contract price for improvement of navigable channel permitted, but no recovery allowed for work done in excess of appropriation).

quirements, be made enforceable by ratification or estoppel. (footnote omitted.)

15 Williston on Contracts §1786A at 345-46 (3d ed. 1972).

The illegality of appellant's agreement with the Government cannot be overcome by protestations against the Government's alleged bad faith or unfair dealing. This court's comments in *In re Hooper's Estate*, 359 F.2d 569 (3d Cir. 1966), a case in which the Virgin Islands Government was permitted to recover from deceased's estate over $1 million in subsidies erroneously granted deceased by the Tax Exemption Board and the Governor, apply equally to this case.

> "• • • Whatever the form in which the Government functions anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority, [and the law.]
>
> • • •
>
> "• • • The oft-quoted observation in *Rock Island, A. & L. R. Co. v. United States*, 254 U.S. 141, 143, 41 S.Ct. 55, 56, 65 L.Ed. 188, 189, that 'Men must turn square corners when they deal with the Government,' does not reflect a callous outlook. It merely expresses the duty of all courts to observe the conditions defined by Congress for charging the public treasury.
>
> • • •
>
> "• • • *The circumstances of this case tempt one to read the regulation[s], since it is for us to read [them] with charitable laxity. But not even the temptations of a hard case can elude the clear meaning of the regulation[s].*"

Id. at 578. (citations omitted) (emphasis added) *quoting Federal Crop Insurance Corp. v. Merrill*, 332 U.S. 380, 384-86 (1947).

III. *HEYL V. RICH*

As previously noted, Rich had a two-prong theory to its litigation strategy. The first, which we have just discussed, was that the Virgin Islands Government breached its contract and therefore Rich was entitled to compensatory damages. Its alternative theory was its defense in the case of *Heyl v. Rich*, wherein Heyl sought damages from Rich. As to the latter, Rich in substance argues that as per its contract with Heyl and standard contract doctrine, Heyl must bear whatever losses it suffered as a result of the debacle on Estate Nazareth. The trial judge rejected Rich's contentions.

A. *Allocation of Risk*

The trial court concluded that the underlying risk of economic loss for the failure of Rich's contract with the Government fell on Rich and that Heyl had a compensable reliance interest which was not waived by the parties' agreement.

Appellant argues, however, that two aspects of its contract with Heyl specifically indicate that Heyl bore the risk of failure of Rich's agreement with the Government: (1) Heyl's duty under Paragraph 1a.46.1 of the Project Specifications to obtain a building permit for the proposed project, and (2) the waiver provision of Article 8 of the Heyl-Rich Agreement.

Neither Heyl nor Rich challenges the trial court's determination that Paragraph 1a.46.1 of the Specifications[14] assigned Heyl the duty to obtain a building per-

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14. Paragraph 1a.46.1 states that:

> The Sub-Contractor shall obtain at his own expense all required permits for the proceeding of his work.

mit. Rich would have us infer from this, however, that both parties intended for progress payments to be contingent upon Heyl obtaining a building permit. We are unable to discern in either the language of Paragraph 1a.46.1 or Article 6,[15] or the subsequent behavior of the parties the intent which appellant would have us find. We find the trial court's finding on this issue was not clearly erroneous.

A more difficult issue is appellant's assertion that Article 8 of its contract with Heyl constitutes a waiver of Heyl's right to sue Rich for breach of contract. Article 8 reads in part:

> The Contractor is aware that the work of this contract is being done pursuant to an agreement between the Owner and Government of the Virgin Islands and that the Contractor has read said contract and understands the provisions contained therein. In the event either the Owner or the Government of the Virgin Islands shall fail to comply with one or

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15. Article 6 states as follows:

PROGRESS PAYMENTS

Based upon applications for Payment submitted to the Architect by the Contractor and Certificates for Payment issued by the Architect, the Owner shall make progress payments on account of the Contract Sum to the Contractor as provided in the Conditions of the Contract as follows:

> On or about the 25th day of each month 90% per cent of the proportion of the Contract Sum properly allocable to labor, materials and equipment incorporated in the Work and 90% per cent of the portion of the Contract Sum properly allocable to materials and equipment suitably stored at the site or at some other location agreed upon in writing by the parties, up to the 25th day of that month, less the aggregate of previous payments in each case; and upon Substantial Completion of the entire Work, a sum sufficient to increase the total payments to 90% per cent of the Contract Sum, less such retainages as the Architect shall determine for all incomplete Work and unsettled claims.

> more provisions of said agreement between them, Contractor agrees it shall make no claim against the *Contractor* [sic] for damages or extra payment allegedly arising from said failure to comply; unless such action directly affects the dwelling unit costs.

(emphasis added). Rich argues that the second "Contractor" in the last sentence was meant to read "Owner," while Heyl contends that the intended words were "Government of the Virgin Islands." We believe the trial court was correct in concluding that the disputed word was intended to read the "Government of the Virgin Islands," as asserted by Heyl, and that Heyl had not waived its right to sue Rich for breach of contract.

Finally, relying upon Restatement (Second) of Contracts §§294 and 296 (Tent. Draft No. 10, 1975)[16] the

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16. Restatement (Second) of Contracts §§294 and 296 (Tent. Draft No. 10, 1975) read as follows:

> §294. WHEN MISTAKE OF BOTH PARTIES MAKES A CONTRACT VOIDABLE.
>
> (1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in §296.
>
> (2) In determining the effect of the mistake on the agreed exchange of performances, account is taken of any relief available by way of reformation, restitution, or otherwise.
>
> §296. WHEN A PARTY BEARS THE RISK OF A MISTAKE.
>
> A party bears the risk of a mistake when
>
> (a) it is allocated to him by agreement of the parties, or
>
> (b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates, but treats his limited knowledge as sufficient, or
>
> (c) *it is allocated to him by a term supplied by the court on the ground that it is reasonable in the circumstances to do so.*

(emphasis added).

trial court determined that Heyl had a compensable reliance interest because Rich bore the risk of the parties' mutual mistake insofar as the legality of Rich's agreement with the Government. Rich objects to the reasonableness of the trial court's allocation of the risk of mistake as provided for under §296(c), but under the circumstances of this case, it clearly was not erroneous for the court to so allocate the risk of mistake as it did and subsequently conclude that Heyl had a compensable reliance interest under Restatement (Second) of Contracts §300, Comment b (Tent. Draft No. 14, 1979), which provides that "a party may also have a claim that goes beyond mere restitution and includes elements of reliance by the claimant."

B. *The Damage Issue*

The question of damages was extensively considered by the trial court, which determined that Heyl's reliance interest entitled Heyl to damages of $262,398.01 plus costs of $2,668.25, attorney's fees of $21,000.00 and prejudgment interest of $841.50. Rich takes issue with the trial court's findings only as to the award of damages for steel which did not conform to contract specifications. Although the contract called for grade 50 steel, Heyl substituted grade 40. On the basis of testimony offered by witnesses for Heyl the trial court concluded that the lower grade steel could and would have been partially utilized on the project. Accordingly Heyl was reimbursed for 50% of the cost of the steel or $33,828.53. Although witnesses for Rich testified that grade 40 steel was not an interchangeable substitute for grade 50 and that substitution would not only be difficult, but also involve extensive design revisions, we cannot conclude from the evidence of record that the district court's finding was clearly erroenous. Consequently we will let stand the $33,828.53 damage award for the steel.

IV.

A PYRRHIC VICTORY

As we stated in the beginning of this opinion, one has to have some disquietude with the results of this decision. There is nothing which this court can do to reassemble the housing project that, like Humpty Dumpty, has been irretrievably shattered, and we are left with choosing among several undesirable alternatives. Families of low and moderate income still don't have housing at Estate Nazareth. The Government has spent substantial sums on this now decimated project; Rich claims that it spent "more than a half million dollars on the Nazareth project in reliance on the Government's own [earlier] recommendation of the townhouse concept." (Appellant's brief at 24). Rich has been subjected to an additional loss by a very substantial judgment below for a project that was aborted in its infancy because of changes in governmental administration. Although the Government has prevailed on appeal because of a plethora of valid technical objections, it seems that the primary reason why the project floundered was not the failures to comply fully with the statutory mandates, but probably because a succeeding governor was not committed to implementing the detailed plan of his predecessor. With the Government's repudiation of its predecessor's work, those who are poor and of moderate income did not get even one of the three hundred houses planned. Much of the Government's money was spent, and a private developer has sustained an extraordinary loss. Using blunt language the appellant asserts that:

> The district court's opinion, if left undisturbed, will undermine the confidence of all those who contemplate entering into solemn contractual obligations with the Government of the Virgin Islands. Moreover, those who have contracts with the Government are now left in grave doubt as to the

enforceability of their agreements.[17] Appellant's brief at 25.

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17. Appellant further asserts in its brief:

> After the Evans Administration, with whom the contract had been concluded, was defeated in the November 1974 election, the new Administration of Governor King simply repudiated the deal. Edmund Strack, Rich's then vice-president in charge of the Caribbean, testified as follows in regard to a meeting with the new Governor in April 1975:
>
> > [I]t was a very discouraging meeting, since little to nothing happened. The Governor seemed to be wrapped up in his own thoughts and we exchanged comments. The meeting lasted less than an hour. And he advised everybody to get together and come back in ten days. It never happened.
> >
> > Q. Well, did he say anything about the Nazareth [project?] —
> >
> > A. He said his commissioner had been saying prior to the committee he did not like the concept that we had. He wanted single houses with lower density, and *he just didn't like the concept of our project, and he didn't want to get stuck with what another administration had [set] up.*
> >
> > Q. He what?
> >
> > A. He didn't want to do something which he felt was wrong that another administration had started.
>
> [App. at 229a-230a] (emphasis added). Mr. Strack's testimony was supported and amplified by Irwin Silver, Rich's Vice-president in charge of sales and development, who was also present at the meeting:
>
> > To the best of my recollection, the governor first of all took exception to the plan we were trying to execute.
> >
> > • • • And he indicated a desire for single family homes. He indicated that he felt the lower density would be more to his liking. He indicated that he did not like the provision, didn't agree with the provision that would require the Virgin Islands to guarantee the sale of the units.
> >
> > • • •
> >
> > • • • And he also did not like the requirement of having to develop the site.
> >
> > Q. To do the site work?
> >
> > A. That's correct.

Though on this record the Government has prevailed, in the long run, if future developments are to be built, this case may be merely a pyrrhic victory for the Government because the winning of this law suit is not the equivalent of meeting the desparate housing needs of the families of poor and moderate income in the Virgin Islands.

Q. Did you have any reaction to this?

A. I was stunned. I indicated to the governor at this point in time he was changing our agreement, and this couldn't possibly happen.

[App. at 235a-237a]

The final repudiation was contained in a letter dated September 2, 1975 from the Executive Assistant to the Governor, Mr. Peter de Zela, who pointed out that the Governor did not approve of the housing plan, wanted a lower density and objected to provisions of the contract which were claimed to be "disadvantageous" to the Government. (App. at 368a, R-26). The letter concluded [Appellants' brief at 8]:

> In closing, I would like to re-emphasize that this new Administration should not be held fully responsible for alleged "unobserved" agreements consummated years prior to assuming office, that the present financial position of the Government may now present an insuperable obstacle in resolving the various problems attending the proposed housing project, and that F. D. Rich itself appears to have failed to observe a number of provisions of the 1973 contract. (App. 369a).

This repudiation came despite the warning from Rich that it and its contractor had expended "in excess of $500,000" in reliance on the contract. (App. at 363a, Exh. R-22). [Appellant's brief at 8, 23-24]

V.

CONCLUSION

For the reasons noted in Parts I, II, and III, the judgments appealed from in both cases will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B

IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF ST. THOMAS AND ST. JOHN*

F. D. RICH HOUSING OF THE VIRGIN ISLANDS INC., as Assignee of F. D. Rich Housing of Puerto Rico, Inc., *Plaintiff* vs. GOVERNMENT OF THE VIRGIN ISLANDS, *Defendant.*	Civil No. 76-62 Action For Breach of Contract
HEYL & PATTERSON INTERNATIONAL, INC. vs. F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC. and F. D. RICH HOUSING CORP., *Defendants* vs. GOVERNMENT OF THE VIRGIN ISLANDS, *Third-Party Defendant*	Civil No. 75-785 Action For Breach of Contract

* In the original of the District Court's opinion, all footnotes were assigned the number "1," except in those instances where a second footnote appeared on the same page, in which case the second footnote was assigned the number "2."

In this Appendix B, all footnotes have been numbered consecutively in the interest of clarity.

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MEMORANDUM OPINION

These consolidated actions arise out of an unsuccessful attempt to construct a middle income housing project at Estate Nazareth, St. Thomas. For our purposes, the scenario opened on October 1, 1973, when, after lengthy negotiations, F. D. Rich Housing of the Virgin Islands, Inc. signed an Agreement with the Government of the Virgin Islands. The Agreement called for the development of 100 units in the first phase of the Nazareth project and left open the possibility of an additional 200 units. In its role as developer, Rich contracted for Heyl & Patterson International, Inc. to serve as general contractor of the Nazareth Project. For a variety of reasons the project never moved past the stage of planning and ordering of materials. Heyl & Patterson has sued Rich for breach of contract and requests consequential damages. Without conceding liability to Heyl & Patterson, Rich has filed a third party action against the Government for indemnification for any liability it may have to Heyl & Patterson as well as for its own consequential damages. A separate action commenced by Rich against the Government for the identical remedies, No. 76-62, has been consolidated with the case presently before the Court.

I. RICH V. GOVERNMENT

For conceptual clarity, it is preferable to begin our analysis with the claims of Rich against the Government. Rich's theory of recovery is straightforward; it had a contract with the Government which was breached and, therefore, it is entitled to damages. The Government's defense may be broken into four categories. Firstly, the Government contends that the Agreement was not supported by consideration moving to the Government and, therefore, there was no binding contract. Secondly, the Government argues that Rich exercised an option pursuant to the Agreement under which Rich could complete the project alone and, accordingly, the Government was completely discharged from further responsibility under the Agreement. Thirdly, the Government maintains that it lacked capacity to enter a contract because of four separate statutory

prerequisites with which there had been no compliance. Specifically, the Government points to the requirements of (1) adequate appropriations, 33 V.I.C. § 3101, (2) legal transfer of the necessary land to the Department of Housing, 29 V.I.C. § 191c, (3) Government adoption of a Housing Development Plan, Act No. 3088, 1971 V.I. Sess. Laws at 313-314, and (4) compliance with statutory cost limitations on middle income housing, 29 V.I.C. § 191n. Since the Government's illegality defenses successfully invalidate the alleged contract, the Court does not reach the Government's final defense that Rich materially breached the Agreement. For the same reason, the Court does not discuss the alleged breaches of the Government or the question or damages.

A. CONSIDERATION

The Government first argues that the October 1, 1973 Agreement does not qualify as a contract upon which Rich can base this action since it provides for no consideration to the Government. The RESTATEMENT OF CONTRACTS § 75(1) defines consideration for a promise as:

> (a) an act other than a promise, or
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> (b) a forbearance, or
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> (c) the creation, modification or destruction of a legal relation, or
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> (d) a return promise, bargained for and given in exchange for the promise.

In light of this definition, the Agreement clearly supplies the Government with sufficient consideration to support a contract. Primarily, as stated in the introductory sections of the Agreement, the Government's goal of encouraging construction of desirable middle income housing is advanced. This objective is solidified by the Government's power to designate the prices of the dwellings (paragraph VII A) and the Government's right to approve plans and specifications (paragraph VIII A). A secondary governmental aim, expeditious construction of the desired buildings, is ensured by the liquidated damage clause

for delay provided in paragraph VI B and VI D of the Agreement. In addition, paragraph IV A requires Rich to pay $7,000 per acre in cash for the land at Estate Nazareth upon which the project was to be built. Obviously, therefore, the absence of consideration is not a defect in the Agreement at issue. Accordingly, the Court need not pursue Rich's contention that consideration might also be found in the advantages to be received by potential purchasers of the homes, the Virgin Island citizens who were allegedly third-party beneficiaries of the Agreement.

B. EXERCISE OF OPTION AND DISCHARGE

As its second defense, the Government maintains that Rich exercised its option under paragraph XI of the Agreement to elect to perform site improvements at its cost in the event the Government was unwilling or unable to fulfill its obligation to perform those improvements. If that is true, then subparagraph XI(B)(3) of the Agreement automatically became operative and, therefore, the Government would be completely discharged from further performance under the Agreement. However, examination of the two letters on which the Government relies to support its contention defuses the Government's theory. These letters, exhibits GVI-Y and GVI-Z, merely evidence a proposal whereby Rich would perform the relevant site work in exchange for monetary compensation directly from the Government. This proposal is significantly different from the option, contained in subparagraph XI(B)(2), which entitles Rich to charge purchasers higher prices for the dwelling units as compensation for performing the site improvements. This crucial distinction as to who pays Rich in combination with the fact that the Government never formally agreed to the Rich proposition signifies that Rich did not elect to proceed pursuant to its option to perform the site work. Thus, the Government was not discharged from its duties under the Agreement because of any exercise of an option by Rich.

C. ILLEGALITY OF THE AGREEMENT

Prior to discussing the Government's illegality defenses themselves, the Court must address Rich's contention that the Government has waived all defenses premised on the illegality of the Agreement except for the defense of the absence of an appropriation. Rich maintains that such a waiver occurred when the Court granted the Government leave to file an amended answer. Rich had objected to the motion to amend on the ground that the Government's new Fourth Affirmative Defense which alleged illegality of the Agreement was too vague. The Government filed a Reply which specified the absence of an appropriation as the source of the illegality asserted in the Fourth Affirmative Defense. As a result, in its March 6, 1979 Memorandum Opinion the Court accepted the Government's clarification as remedying Rich's vagueness objection. Rich's present contention is that the Court's statement is tantamount to a grant of the amendment on terms. *See* 3 MOORE'S FEDERAL PRACTICE ¶15.08[6] at 15-124 to 125 (2d ed. 1979). In effect, Rich argues that the grant of leave to amend the answer was conditioned upon the Government waiving any additional defenses based on the illegality of the Agreement.

Rich's theory, that regardless of the Agreement's illegality, the Court cannot consider the relevant statutes, is unacceptable. It is perhaps fair to conclude that the Government should be prohibited from utilizing its Fourth Affirmative Defense to assert defenses other than the absence of an appropriation. However, no further inferences can be gleaned from the Court's opinion. Certainly, a party is able to amend its pleadings at any time up to, during, and even after trial. C. Wright & A. Miller, FEDERAL PRACTICE AND PROCEDURE: Civil § 1488 at 438 (1971). Thus, the Government was free to move to amend its answer at any time during the trial. That is precisely what the Government did when it raised its alternative illegality defenses in its opening statement. The sole limitation upon the Court's "liberal" discretion to grant leave to amend, even at that late date, is an affirmative showing that the Government

"has been guilty of delay in requesting leave to amend and, as a result of the delay, the proposed amendment, if permitted, would have the effect of prejudicing..." Rich. *Id.* at 439. Aside from a bit of puffing, such a showing, especially as to the requirement of prejudice from the delay, is conspicuously absent from Rich's memoranda. Accordingly, all affirmative defenses asserting illegality of the Agreement will be examined by the Court.

(1) ADEQUACY OF APPROPRIATIONS

The first illegality defense raised by the Government labels the Agreement a nullity because it attempts to commit government funds without, or in excess of, any prior appropriation. *See* 33 V.I.C. § 3101. This Court has held that a contract not executed in conformity with a legislative appropriation of funds is void. *Sargeant* v. *Government,* 10 V.I. 245, 248 (D.V.I. 1973). The rationales expressed in *Sargeant* are equally applicable in the case at bar. Firstly, § 3 of the Revised Organic Act forbids payment out of the Virgin Islands Treasury except pursuant to an Act of Congress or a "money bill" of the local legislature. Secondly, 31 V.I.C. §§ 248-249 state that a contract on behalf of the Government not under an appropriation adequate to its fulfillment "shall be null and ineffective". *See Sargeant* v. *Government,* 10 V.I. at 245-46. While conceding that *Sargeant* states the controlling law, Rich contends that *Sargeant* is inapposite because the Government has failed to satisfy its burden of proving the absence of sufficient appropriations. *See* Fed. R. Civ. P. 8(c) (illegality is an affirmative defense).

The first step in evaluating the sufficiency of the appropriations is to determine the extent of the Government's financial obligations under the Agreement. Two duties which devolved upon the Government can be characterized as financial; the Government is obligated under paragraph IV B to do the site improvements for the Nazareth project and under paragraph X to purchase units not sold to the public. In the abstract, the Government's obligation to purchase unsold dwellings is im-

mense. The maximum exposure is approximately $2.5 million assuming the average price per unit to be $25,000 and no unit would ever be sold to the public. In light of the facts of the case at bar, however, the potential liability is of minimal significance. According to Joseph Simmonds, Business Manager of the Department of Housing, by October 1, 1973 there was already $66,100 in deposits in the Moderate Income Housing Special Deposit Account. Thus, at the time the Agreement was signed, at least 66 of the 100 units were spoken for. Simmonds also testified that shortly thereafter the Account contained over $91,000 representing at least 91 purchasers. Moreover, testimony such as that of Irwin Silver demonstrates the proposed selling prices were significantly below market value and, therefore, there would be no difficulty in selling the units. Thus, the combination of a high number of deposits and the bargain price indicates the slight likelihood of the need ever arising for the Government to purchase unsold units.

In addition, there exists a completely different basis for ignoring the Government's potential purchase liability since it is questionable whether Rich could enforce the purchase provision. *See* 1A GOVERNMENT CONTRACTS § 8.20[5] at 821(1979) (Stating that clauses obligating the federal government to indemnify a contractor against third-party claims are limited to the unexpended balance of an appropriation. This passage also suggests that contingency clauses do not invalidate a contract despite the fact that the clause may result in governmental liability in excess of an appropriation.) Regardless of the provision's enforceability, however, it would be incorrect to hold that the potential for an unlikely contingency to arise during the final stage of a contract should serve to nullify the existence of the entire contract at the outset.

The extent of the Government's other financial obligation under the Agreement, the site work, can be predicted with greated [sic] accuracy. Darwin Creque, the Commissioner of Housing on October 1, 1973, the date the Agreement was signed, testified that as of that date the Department of Public Works would have required $1.5 million to complete the site

work. Gordon Finch, the Commissioner of Public Works from February, 1975 to March, 1979, testified that as of October, 1973, the site improvements would cost $1.1 million. Finch's appraisal was based on the discounted value of the $1,325,000 estimate he made of the cost as of March 14, 1975. (exh. GVI-F). Finally, on behalf of Rich, Edmund Strack proposed to do the site work for $1.3 million on February 14, 1975. (exh. GVI-Z). This amount would also be discounted to approximately $1.1 million to account for the one and one-half year span between the estimate and October, 1973. Since the latter two estimates substantiate one another and since the individuals calculating those estimates[1] are extremely familiar with the variables involved, the Court concludes that $1.1 million was the amount of the site work obligation which the Government undertook in October, 1973.

The Government has raised the possibility of one additional financial obligation imposed on it by the Agreement. That is Exhibit GVI-0, a change order sent by Commissioner Creque to Rich on October 16, 1974. According to the change order, Rich would take on the Government's duty to attempt to provide a commitment for permanent mortgage loans in exchange for a Government promise to pay Rich $1,200 per unit at the time of sale and a reduced price for the Nazareth land. Rich's response, that this additional cost would be passed on to the purchasers, is without factual support, especially in view of the unambiguous language of the order. However, a change order unsupported by an appropriation could not be enforced by the developer. *See* 1A GOVERNMENT CONTRACTS § 8.20[1] at 8-15. Thus, the change order was unauthorized and this potential liability need not be considered by the Court.

Accordingly, as to appropriations, the sole remaining issue is whether the Government satisfied its burden of proving the inadequacy of appropriations for the site work. Initially, the Government contends that regardless of the amounts the

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[1] Gordon Finch was Commissioner of the Department of Public Works for four years. Edmund Strack is an experienced construction contractor and was Rich's vice-president in charge of the Estate Nazareth Project.

Legislature may have approved, those funds were never allocated by the Budget Office to the Department of Housing and, therefore, were never formally "appropriated." This argument is, however, inconsistent with the accepted definition of "appropriation", "(t)he act by which the legislative department of government designates a particular fund, ... to be applied to some general object of governmental expenditure, or to some individual purchase or expense". BLACK'S LAW DICTIONARY 93 (5th ed. 1979). Thus, the existence of an "appropriation" does not require that all internal mechanisms of the executive branch are activated; instead, as long as the legislature has designated funds for use by the executive branch and the appropriation measure has received executive approval, an "appropriation" has been made.

Alternatively, the Government argues that even if some appropriations were indeed made, they were insufficient to meet, in full, the cost of the site work which the Government is obligated to perform under the Agreement. The Court has already calculated that amount.[2] In light of the definition of "appropriation" adopted above, the Government must concede that a $200,000 appropriation for the site work was made on July 2, 1973. *See* 1973 V.I. Sess. Laws. Act No. 3445. As to the remainder of the Government's obligation, Rich points to several potential sources of Government funds. Although Rich comes extremely close, it is unable to unearth adequate appropriations which might have been applied toward the site work so as to satisfy the legal requirements.

Rich correctly suggests that for the fiscal year from July 1, 1971 to June 30, 1972, the Legislature appropriated $750,000 for the "(c)onstruction of roads and site improvements, Estate Nazareth, including recreational facilities." 1971 V.I. Sess. Laws Act No. 3054. The Government regards this appropriation as having lapsed before October 1, 1973 and, therefore, maintains that it cannot be considered as supplying funds for the obligations undertaken in the Agreement of that date. However, the prefatory language of Act No. 3054 states that

[2] $1.1 Million.

the appropriations made therein "shall remain available until expended for the projects and purposes hereinafter expressly named." Hence, the appropriation of $750,000 remains valid since 33 V.I.C. § 3111 provides that an appropriation does not automatically expire at the end of the fiscal year if it is "otherwise provided by law." *See* 7 V.I. Op. A.G. 356. Accordingly, this $750,000 may be added to the $200,000 previously discussed and it is established that $950,000 of the $1.1 million necessary for the site work was appropriated.[3]

As to the remaining $150,000, Rich suggests that various general appropriations could provide the money. Specifically, Rich points to the Moderate Income Housing Fund (Mr. Simmonds testified it contained $300,000 in 1973) and the Public Works Discretionary Fund (Commissioner Finch testified it contained $200,000 per year for road work in 1975). Alternatively, Rich proposes the Road Fund for General Maintenance ($800,000), a Federal Highway Grant Matching Contribution ($800,000) and a general fund for construction and improvements of roads ($1,000,000). *See* 1973 V.I. Sess. Laws, Acts No. 3444 and 3445. The fallacy of each of these examples, as well as several others advanced by Rich, is that the issue is not whether or not the Government had sufficient funds in its entire budget to support the contract. Instead, the issue is whether or not adequate funds were "appropriated" to enable the Government to fulfill its site improvement obligation under the Agreement. In this regard, the law is clear that general appropriations of the type relied upon by Rich cannot supply the shortfall left from inadequate specific appropriations. *See* 1A GOVERNMENT CONTRACTS § 8.20[1] at 8-15. Thus, there exists no appropriations as such to furnish the final $150,000 of the Government's site work obligation.

This conclusion does not totally defeat Rich's argument, however, since it has been held that substantial compliance with the appropriation requirement may suffice. *See Fowler v.*

[3] Admittedly, some reduction in the $750,000 appropriation must be made to account for the fact that "recreational facilities" are included in the total.

United States, 3 Ct. Cl. 43 (1867). *Fowler* interprets 41 U.S.C.A. § 11, the federal analogue to 33 V.I.C. § 3101's, requirement of an adequate appropriation to consider a contract authorized. The *Fowler* court held that a congressional act authorizing the enlargement of the library of Congress is "a law authorizing" a contract even though the contract slightly exceeds the appropriation made for that purpose. *Id.* Accordingly, the Court is compelled to consider whether the fact that $950,000 of the necessary $1.1 million was appropriated signifies that the *Fowler* notion of substantial compliance is satisfied in the case at bar.

There are several points in Rich's favor on the question of substantial compliance with the appropriation requirement. Most important, the escrow fund to be established pursuant to paragraph XI A of the Agreement[4] might be considered as a source of funds to fill the appropriation shortfall. The Government was required to deposit $250,000 into the fund on the date of commencement of construction of Phase I to secure the performance of its covenants to buy unsold units and to perform the site work. In addition, upon conveyance of the deeds for the Estate Nazareth property, paragraph IV A required Rich to deposit the sales price of the land, $92,400, into the identical escrow fund. The Government was prohibited from withdrawing any monies from escrow until the site work was completed and all units were sold. Since the $250,000 was never appropriated, it is apparent those funds cannot be considered as support for the Agreement. It is a much closer question, however, as to the $92,400 for the land. Although Rich never deposited these funds, the Agreement could not have proceeded for long without such a payment. Additionally, we have already mentioned that the Government could not withdraw the monies from escrow until the site work was completed.[5] Thus, the $92,400 had an effect remarkably

[4] The escrow fund was never established and, obviously, no funds were actually deposited in it.

[5] The Court concedes the presence of some circular reasoning in its analysis. Certainly, the requirement of a deposit and the prohibition upon using funds in escrow only come into force if the contract exists in the first place. However, the essential point remains, the $92,400 was specifically set aside to guarantee the completion to the site work.

similar to an appropriation in the sense of the funds being set aside for a specific purpose.

Rich can also point to two factors suggesting that the estimate of the necessary site work appropriation is inflated. One factor is the $50,000 the Department of Housing advanced to the Department of Public Works for rough cutting of roads at Nazareth. (exh. R-10).[6] In effect, since the money was expended and the work actually done, it is possible to infer that the Government's remaining financial obligation for the site might have been correspondingly reduced. The second factor is the testimony at trial suggesting that the $1.1 million estimate for site work included some costs more appropriately allocable to a planned second phase of the project rather than to the 100 units which were the subject of the Agreement. Thus, Rich has several proposals for shaving down the estimate as well as for filling the appropriation shortfall.

Nevertheless, a stronger case can be made for finding that sufficient appropriations were not made since any doctrine of substantial compliance must be interpreted very narrowly. "It is well settled that contracts with agents of the Government must be in strict conformity with the authority conferred." *In re Hooper's Estate*, 359 F.2d 569, 577 (3d Cir. 1966) (citations omitted). *Hooper* goes on to state that "(t)he Government is neither bound nor estopped by acts of its officers or agents in entering into an arrangement or agreement to do or cause to be done what the law does not sanction or permit." *Id.* (citations omitted).

In light of the *Hooper* mandate, the considerations weighing against finding substantial compliance overwhelm Rich's argument. Firstly, the 1972 appropriation of $750,000 essential to Rich's position includes an amount for "recreational facilities." Thus, the appropriation shortfall is necessarily increased. Secondly, although the Court concluded that the Government's contingent obligation to purchase unsold units was extremely

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[6] Although this represents a Government attempt to commence the project, it is not a legislative "ratification" of the contract through a post-contractual appropriation. *See* 1A GOVERNMENT CONTRACTS § 8.10[1] at 8-5.

unlikely to be enforced, the enormous potential liability remains a factor which cannot be totally ignored. Thirdly, the $250,000 that the Government was required to put into escrow, while not precisely an appropriation, was still a substantial sum essential to the Agreement for which there is no indication of Government intent or ability to set aside. Finally, although the $92,400 to be paid into escrow by Rich for the land is an equitable factor in Rich's favor, it is still not an appropriation as required by law. Accordingly, the Agreement is unvalid [sic] under 33 V.I.C. § 3101 because it attempts to commit government funds in excess of any prior appropriation.

(2). TRANSFER OF LAND TO HOUSING DEPARTMENT (29 V.I.C. 191c)

As a second illegality defense, the Government maintains that the Agreement is illegal because neither of the two statutes which could authorize the sale to Rich of the land essential to the Agreement, 29 V.I.C. § 191c and 31 V.I.C. § 205, were ever complied with. Section 205 is a general provision for the disposition of government real property. Subsection 205(d)(2) states that Section 205 is inapplicable to the disposition of Government real estate under subchapter IX of Chapter 1, Title 29, Relating to Home Ownership and Development. Since the Agreement clearly involves a contractual arrangement entered by the Department of Housing for the sale of Government land for moderate income housing under subchapter IX of Chapter 1, Title 29, § 205 is not available as a basis for the transfer.

Accordingly, compliance with the only alternative available, § 191c, is crucial to the validity of the Agreement. Under § 191c,

> (T)he Governor with the approval of the Legislature is authorized to transfer to the jurisdiction of the Department of Housing and Community Renewal, for disposal in accordance with the provisions of this subchapter, any plot or plots of land presently owned or hereinafter acquired by the Government of the Virgin Islands, if such land is not needed for any other public purpose.

Rich points to Act 3005, 1971 V.I. Sess. Laws as constituting § 191c's requisite approval of the Governor and Legislature. Act 3005 states:

> all government-sponsored housing constructed on certain lands at Estate Nazareth, St. Thomas,... shall be constructed and offered for sale pursuant to the provisions of subchapter IX "Home Ownership and Development" of Chapter 1 and of Title 29 of the Virgin Islands Code.

Admittedly, Act 3005 is not an express transfer of the Nazareth land to the Department of Housing. Yet, in light of the Court's conclusion above that section 191c represents the sole method for disposal of Government lands for middle income housing, the logical inference to be drawn from Act 3005 is that it was intended to transfer the Nazareth land to the Department of Housing. To interpret Act 3005 otherwise would leave the Nazareth land frozen from use for its intended purpose as well as for its prohibited purposes. Furthermore, in the context of the case at bar, this conclusion is supported by the previously enuciated [sic] rule that the burden of proving illegality is on the Government. Thus, the Court finds that Act 3005 satisfies the requirement of § 191c that the Nazareth land be transferred to the Department of Housing.

(3). ADOPTION OF HOUSING DEVELOPMENT PLAN (ACT NO. 3088)

A third ground asserted by the Government for finding the Agreement illegal is the absence of legislative approval of a "housing development plan" as required by Act No. 3088, 1971 V.I. Sess. Laws at 313-14:

> To Require the Adoption of a Comprehensive Housing Development Plan Prior to the Construction of Government-Sponsored Housing Projects and for other purposes
>
> Be it enacted by the Legislature of the Virgin Islands:
>
> SECTION 1. Notwithstanding any other general or specific law to the contrary, no housing project, housing

> development or housing unit shall be constructed under the jurisdiction of the Department of Housing and Community Renewal or the Virgin Islands Housing Authority unless a "housing development plan" therefor is first adopted and submitted to the Governor and the Legislature for approval. The housing development plan required by this Act shall be a statement by words, maps, graphics and other appropriate forms of the overall proposed housing project.

There is no question of the Governor's approval since Governor Evans signed the Agreement which included plans and drawings sufficient to comply with the Act. Rich concedes, however, that the Legislature never adopted a plan sufficient to comply with Act 3088. Instead, Rich maintains that either Act 3088 was inapplicable to the Agreement or the Legislature waived its right to approve a plan.

Rich bases its contention that Act 3088 is inapplicable to the Nazareth project on the phrase "under the jurisdiction of the Department of Housing" in Act 3088. Rich interprets the phrase as limiting the Act's applicability to those situations in which the Department actually constructs a project itself or causes the housing to be constructed for ownership by it. The Court, however, reads Act 3088's coverage more broadly so that government sponsorship rather than complete government control is all that is required.

The Court's broader interpretation of Act 3088 is consistent with the relevant legislative enactments. Firstly, Act 3088 is entitled: "To Require the Adoption of a Comprehensive Housing Development Plan Prior to the Construction of *Government—Sponsored* Housing Projects..." (emphasis added). This alone indicates that the Government need not build the project itself. Secondly, the preamble to the Agreement specifically states that the Government is "acting by and through the Commissioner of Housing and the Government." This suggests that the Nazareth project is within the purview of the Department of Housing and, therefore, is covered by Act 3088. Finally, the preamble also states: "this Agreement relates

to a Moderate Income Housing Project as defined in said Title 29." Yet the definition of Moderate Income Housing for Title 29 in no way implies that such projects must be constructed by the Department of Housing itself. *See* 29 V.I.C. § 191(b). It is logical to conclude, therefore, that Nazareth project was "under the jurisdiction of the Department of Housing" so that Act 3088 applies to the Agreement.

Rich also argues that Act 3088 is inapplicable to the Agreement because, interpreted literally, Act 3088's sole prohibition is "no housing project...shall be constructed" without an approved plan. Thus, technically speaking, in contrast to performing construction, a contract to construct housing without prior approval of a plan is not prohibited by Act 3088. The Court does not, however, adopt such a literal interpretation. The clear intent of the statute is to mandate approval of a plan prior to either embarking on actual construction or entering a contract to construct.

Rich's final response to the Act 3088 challenge is that the Legislature waived its right to approve the housing development plan by appropriating funds for site work in 1972 and 1973. Certainly, "(i)t is well settled that Congress may, by enactment not otherwise inappropriate, 'ratify...acts which it might have authorized,' and give the force of law to official action unauthorized when taken." *Swayne & Hoyt, Ltd.* v. *United States,* 300 U.S. 297, 301-302 (1937) (citations omitted). Furthermore, appropriations may in some instances constitute ratifications. *Associated Electric Cooperative, Inc.* v. *Morton,* 507 F.2d 1167, 1174 (D.C. Cir. 1974). Ratifications are, however, normally associated with legislative actions following unauthorized executive conduct. In contrast, the $750,000 and $200,000 site improvement appropriations were passed prior to the October 1, 1973 Agreement. Regardless of this fact it is still the notion of "ratification" that is most helpful in analyzing Rich's hypothesis that the appropriations manifested a waiver of the Legislature's right to approve a housing development plan.

The Court has no problem with holding that the ratification by appropriation analysis is as applicable to the Virgin Islands Legislature as it is to Congress. A prime manifestation of the potential implications of an appropriation is illustrated by 33 V.I.C. § 3101, the statute on which the Government relies to defeat Rich's claim:[7]

> § 3101. Expenditures or contracts in excess of appropriations
>
> No officer or employee of the Virgin Islands shall make or authorize an expenditure from, or create or authorize an obligation under, any appropriation or fund in excess of the amount available therein; nor shall any such officer or employee involve the government in any contract or obligation for the payment of money for any purpose, in advance of appropriations made for such purpose, unless such contract or obligation is authorized by law.

The next-to-last phrase of § 3101 contains language limiting the prohibition on entering unauthorized contracts to those contracts entered "in advance of appropriations made for such purpose." Thus, the clear implication is created that when, as in the case at bar, specific appropriations exist prior to the date on which an otherwise unauthorized Agreement was signed, the contract may then be deemed authorized. Thus, the state of the law in combination with the previously established rule that the burden of proving illegality is squarely on the Government makes a strong case for Rich's theory of waiver of the Act 3088 requirements.

The stumbling block in Rich's ratification theory is the judicially created limitation that ratification will not be found unless prior knowledge of the specific disputed action can be clearly demonstrated, *D.C. Federation of Civic Associations* v. *Airis*, 391 F.2d 478, 482 (D.C. Cir. 1968), and the appropria-

[7] The Government emphasizes that pursuant to the final phrase of § 3101 which requires the contract to be "authorized by law," the failure to formally approve a plan as mandated by Act 3088 signifies that the Agreement is illegal.

tion plainly shows "a purpose to bestow the precise authority which is claimed". *Ex Parte Endo,* 323 U.S. 283, 303 n.24 (1944). Courts reaching the issue usually focus on the rule that when a lump sum appropriation is made for a program without amounts being earmarked for a challenged portion, no approval of that portion may be inferred. *See e.g. Ex parte Endo,* 323 U.S. at 303 n.24. This rule is inapplicable in the case at bar since the appropriations were specifically labeled for the Estate Nazareth Project. However, the rationale underlying the lump sum rule is extremely relevant since it emphasizes that factors attesting to the legislature's specific knowledge of the act it ratifies must be demonstrated. *See D.C. Federation of Civic Associations, Inc.* v. *Airis,* 391 F.2d at 481.

Thus, the ultimate question is what state of the Legislature's knowledge can be inferred from the site work appropriations. Certainly, no awareness of any waiver of the right to approve a housing development plan was exhibited by the Legislature. The Commissioner of Housing, Darwin Creque, testified that on the last day of the Ninth Legislature (1971-1972), the Legislature sat as a committee of the whole and considered the Nazareth project.[8] Yet this fact cannot be utilized to establish knowledge of the Legislature. The 1972 appropriation of $750,000 was made before the last day of the Legislature and, therefore, without the benefit of this meeting. The 1973 appropriation of $200,000 was subsequent to the meeting, but it was made by the Tenth Legislature and knowledge obtained by earlier Legislatures cannot bind subsequent ones. In addition, the fact that the proposed Agreement with Rich may have been circulating within the executive branch at the time of the 1973 appropriation in no way implies that its contents were conveyed to the Legislature. Accordingly, while Legislative appropriations for site improvements may suggest veiled approval for the Nazareth project in general, they cannot be deemed to establish either waiver or

[8] Despite Creque's recollection that the Legislature approved the project, the Court makes no finding of formal approval since no records have been produced to substantiate that allegation.

ratification of the housing development plan.[9] Thus, the absence of legislative approval of a plan as required by Act 3088 condemns the Agreement as illegal and unenforceable by Rich.

(4) COST LIMITATIONS (29 V.I.C. 191n)

The fourth illegality defense asserted by the Government is that the Agreement violates 29 V.I.C. § 191n[10] which sets minimum and maximum prices for the sale of government-sponsored housing. Rich maintains that since § 191n(a) expressly and § 191n(b) by implication are applicable to dwellings "erected by the Government", the statute is inapplicable to a project Rich would construct on its own. However, this literal interpretation flies in the face of the clear intent of the statute. The Agreement expressly states that it is addressed to middle income housing under Title 29 of the Virgin Islands Code. Thus, there is no question that it is subject to the dictates of 29 V.I.C. § 191n. Section 191n(a) guarantees that government efforts under Title 29 are confined to middle income housing by setting a maximum construction cost of $25,000. Section 191n(b) involves the additional step of insuring that such dwellings are sold at cost so that governmental aid is limited to reducing the profit element in the housing prices rather than to going the additional step of taking a loss. Finally, there is simply no indication that Title 29 envisioned the Government performing the actual construction of dwellings. It is logical to assume, therefore, that the language "erected by the Government" covers the situation in which the Government sponsors a project but the actual construction is completed by private enterprise.

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[9] Moreover, the Court's earlier holding that the Legislature's appropriations for the Nazareth project were inadequate also implies that the appropriations should not be construed as constituting "ratification" of the project without a plan.

[10]—

(a) No dwelling shall be erected by the Government at a cost of more than $25,000 exclusive of the proportional cost of the land.

(b) The minimum selling price for a dwelling shall be a sum at least equal to the Government's acquisition cost plus the cost of any additions and improvements.

Once section 191n's applicability to the project is confirmed, it is apparent that the Agreement fails to comply with it. The provisions of the Agreement at issue are contained in paragraph VII:

> A. The selling prices of the units, the construction of which is commenced on or before October 1, 1973, shall be as follows:
>
> | | |
> |---|---|
> | Two (2) Bedroom Units ..... | $22,050.00 |
> | Three (3) Bedroom Units ..... | 23,525.00 |
> | Four (4) Bedroom Units ..... | 25,200.00 |
>
> B. The selling prices of units, the construction of which is commenced after October 1, 1973, shall be the selling prices set forth above adjusted by an increase to be negotiated which shall not exceed the difference between the Construction Cost Index as published by the United States Department of Commerce for the month in which such construction of respective units is commenced and the Construction Cost Index for the month of October 1973 plus 5%.

Since the Court is concerned with the validity of the Agreement as of the date it was signed, no consideration will be given to the potential effects of the escalation clause in subparagraph B.

As to the maximum price, subsection 191n(a) states that "(n)o dwelling shall be erected by the Government at a cost of more than $25,000 exclusive of the proportional cost of the land." The cost to Rich of the land for the 100 units was to be $92,400 or $924 per unit. The Court adopts this figure as the "proportional cost of the land" to be deducted. Accordingly, the $25,000 limit is satisfied for all types of units if the only costs to be considered are the price of the land and the prices at which Rich was to sell the units.[11]

However, the additional element of the site work must be considered. The Court found the cost of the site work for the

[11] In the list of prices in paragraph VII-A of the Agreement, the maximum price, that of a four bedroom unit, is $25,200 including land.

100 units to be approximately $1.1 million or $11,000 per unit. Even if a portion of the site work is allocated to the planned second phase of the project, the site work cost remains so substantial that there is no way the dwellings could have been erected within the $25,000 limitation set by section 191n(a).

Accordingly, Rich can salvage the Agreement only if it can be established that the site work expenses should not be included in the cost of construction. It might be argued that the Government would retain title to the site work so that those costs need not be tacked onto the sales price. Yet paragraph IVA of the Agreement eliminates such speculation since it expressly states that the price of the land to Rich "shall include site improvements." Perhaps a technical argument could be made that the cost of erection are [sic] somehow different in kind than the costs of site work, but such an interpretation would be inconsistent with the intent of section 191n(a) to limit the total cost of middle income dwellings. Thus, the Court concludes that the Agreement is illegal under Section 191n(a) and, therefore, unenforceable by Rich.

A similar result follows from application to the Agreement of Section 191n(b)'s requirement that "[t]he minimum selling price for a dwelling shall be a sum at least equal to the Government's acquisition cost plus the costs of any additions and improvements". Considering the identity of the term "improvements" in the statute and "site improvements" in the Agreement, it is obvious that the site work costs must be passed on to Rich and the prospective purchasers. Paragraph IVA, however, states that the land including site improvements shall be sold to Rich at $7,000 per acre. In light of the uncontradicted testimony that the acquisition cost of the land from Henry Reichold amounted to approximately $7,000 per acre, (Exh. GVI-X), it is apparent that the Agreement did not satisfy the section 191n(b) standard. Moreover, it should be noted that if the Agreement had provided for the site work cost to be passed on in order to comply with section 191n(b), it would necessarily have breached the $25,000 limitation of section 191n(a). Accordingly, under both requirements of section 191n, the Agreement is illegal and unenforceable.

D. CONCLUSION

Hence, Rich successfully eliminated the Government's first two defenses that the Agreement was not supported by consideration moving to the Goverment and that Rich exercised an option pursuant to the Agreement under which Rich would complete the project alone. However, of the Government's four illegality defenses, Rich was only able to counter the defense that there was no legal transfer of the necessary land to the Department of Housing as required by 29 V.I.C. § 191(c). Consequently, the Government has raised three valid defenses which signify that the Agreement is unenforceable by Rich: (1) the Agreement violated 33 V.I.C. § 3101 because it created Government financial obligations in excess of appropriations; (2) the Government never adopted a Housing Development Plan for the Nazareth project as required by Act 3088, 1971 V.I. Sess. Laws at 313-314; and (3) the Agreement did not comply with the cost limitations on middle income housing established by 29 V.I.C. § 191n. A proposed Judgment will be submitted to the Court by the Government dismissing Rich's claims and rendering judgment in favor of the Government.

II. HEYL & PATTERSON v. RICH

As compared with Rich's action against the Government, Heyl & Patterson's breach of contract action is relatively straightforward. On September 5, 1974, Rich, as developer, and Heyl & Patterson, as contractor, entered into a construction contract (exh. R-8) under which Heyl & Patterson was to perform all the labor and provide all the materials for the one hundred units of Phase I of the Nazareth Project. Neither party challenges the validity of this contract. Heyl & Patterson does contend that Rich breached Article 6 of the Contract by failing to make timely progress payments for "materials and equipment suitably stored at the site." Rich concedes that it never made any progress payments but interposes several defenses. Firstly, Rich maintains that Heyl & Patterson expressly waived its right to sue Rich for breach of contract. Alternatively, Rich maintains that its duty to make progress payments never came

to fruition because either its duty was discharged due to frustration of purpose of the contract, or Heyl & Patterson failed to acquire a building permit, an alleged condition precedent to such payments.

A. WAIVER

Rich contends that the following paragraph in Article 8 of the contract constitutes a waiver of Heyl & Patterson's right to sue for breach of contract:

> The Contractor is aware that the work of this contract is being done pursuant to an agreement between the Owner and Government of the Virgin Islands and that the Contractor has read said contract and understands the provisions contained therein. In the event either the Owner or the Government of the Virgin Islands shall fail to comply with one or more provisions of said agreement between them, Contractor agrees it shall make no claim against the Contractor for damages or extra payment allegedly arising from said failure to comply; unless such action directly affects the dwelling unit costs.

Before addressing the scope of the waiver, the Court must first resolve a dispute as to a typographical error to determine whether the provision protects Rich or the Government. The language in question is: "Contractor agrees it shall make no claim against the Contractor (sic). . . ." Both parties acknowledge that the first "Contractor" refers to Heyl & Patterson and that the second "Contractor" is a mistake. However, Rich maintains that the proper word is "Owner" (Rich) while Heyl & Patterson argues for "Government of the Virgin Islands."

Rich would offer two rationales in support of its interpretation. Rich asserts that since the parties negotiated for their own interest, neither would have an incentive to protect the Government. Secondly, Rich reasons that Heyl & Patterson never had the right to sue the Government for breaches of the Agreement with Rich and, therefore, there would be no necessity for waiving that right. Rich's premise that Heyl &

Patterson lacked the right to sue the Government is based on the assumption that the contract represented solely a delegation of Rich's duties under the Agreement with the Government and not an assignment of Rich's rights.

Rich's reasoning on the intended phrase is powerful, but flawed. Initially, adoption of Rich's interpretation would provide Rich with massive immunity from its own misconduct, a result extremely unlikely to have been acquiesced in by Heyl & Patterson. In addition, inserting "Owner" into the disputed phrase would be inconsistent with the subsequent paragraph in Article 8.[12] That paragraph specifically prohibits Heyl & Patterson from suing Rich for damages resulting from the Government's site development work. Yet if the disputed paragraph reads as Rich claims, then it would grant Rich blanket immunity from suits by Heyl & Patterson for Government breaches of the Agreement and, therefore, a prohibition against suits based on a specific Government obligation under the Agreement, the site work, would be totally unnecessary.

Finally, Rich's strongest argument remains: Heyl & Patterson could not have sued the Government in the first place and, therefore, the parties would not have bothered to insert a provision prohibiting such suits. Although this contention is persuasive, it loses its force in the context of a paragraph written with little care and exhibiting minimal comprehension of the applicable legal principles. In effect, the Court has no basis for presuming the parties to have been aware of the legal principles involved when it is equally reasonable to conclude that the parties mistakenly believed Heyl & Patterson would

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The Contractor shall make no claim for damages or extra payment against the Owner for activities of the Government of the Virgin Islands for site development work done pursuant to the agreement between the Owner and Government of the Virgin Islands and further the Contractor shall make no claim for delay or damage by reason of the condition of the site; roads or utilities, and Owner shall not be held responsible for difficulty of access and further Owner shall not be required to provide access to the site or any part thereof. Work not done by government on time shall be no cause for holdup of payment to Contractor otherwise due. The Government shall be responsible for any physical damage done to dwelling units due to their operations at the site.

have the right to sue the Government and provided for such a contingency. Thus, the paragraph in question is not a waiver of any of Heyl & Patterson's rights against Rich.

Yet, even if Rich prevailed on its contention that "Owner" was intended, the waiver would not apply to the case at bar. As written, the waiver applies only when "either the Owner (Rich) or the Government of the Virgin Islands shall fail to comply with" the Agreement. But, the resolution of Rich's claim against the Government indicates that the Agreement was illegal. Thus, the question of breach lacks any significance and the waiver clause is without consequence. Alternatively, if an illegal contract could actually be breached, the facts presented suggest that most of Heyl & Patterson's damages occurred prior to the alleged breach by the Government, the repudiation of the Agreement. Accordingly, the waiver would be inapplicable to Heyl & Patterson's damages since they were not caused by the Government's breach.

B. MISTAKE

Even if Heyl & Patterson did not waive its right to sue for breach of contract, Rich maintains that Heyl & Patterson cannot succeed on the merits since there was no breach. Rich's primary argument is that the adjudged illegality of the Rich—Government Agreement so frustrated the purpose of the Rich—Heyl & Patterson contract as to discharge Rich from its obligation to make progress payments. Unfortunately, neither of the parties' analyses of the issue is of much utility since each party incorrectly assumes that it had no reason to suspect the illegality. Rich, a party to the illegal Agreement, cannot with a straight face make such an assumption. Similarly, in light of the clause in Article 8 of the contract in which Heyl & Patterson acknowledges that it has "read said contract (the Rich—Government Agreement) and understands the provisions contained therein," Heyl & Patterson cannot claim inadequate opportunity to discern legal improprieties. Accordingly, neither party can rely on the doctrine of existing frustration of purpose since RESTATEMENT (SECOND) OF CON-

TRACTS §286 (Tent. Draft No. 9 1974) requires that a party have "no reason to know" of the illegality, "the nonexistence of which is a basic assumption on which the contract is made."

The erroneous but not completely blameless assumption of both parties as to the validity of the Agreement suggests that the applicable law is RESTATEMENT (SECOND) OF CONTRACTS §294 (Tent. Draft No. 10 1975):

> §294. WHEN MISTAKE OF BOTH PARTIES MAKES A CONTRACT VOIDABLE.
>
> (1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in § 296.
>
> (2) In determining the effect of the mistakes on the agreed exchange of performances, account is taken of any relief available by way of reformation, restitution, or otherwise.

The § 294(1) doctrine of mistake covers situations in which three elements are present. *Id.*, Comment a. There is no question on the first condition; the parties' mistake as to the legality of the Agreement relates to a "basic assumption on which the contract was made." *Id.* Similarly, the second element, that "the mistake has a material effect on the agreed exchange of performances," *id.*, is easily satisfied because the Agreement's illegality completely undermines the Heyl & Patterson—Rich Contract. Less certain of fulfillment is the third requirement, that "the mistake must not be one as to which the party seeking relief bears the risk." *Id.* The Court now finds that if either of the two parties bear the risk, it would have to be Rich, not the party seeking relief, Heyl & Patterson.

Section 294 expressly refers to RESTATEMENT (SECOND) OF CONTRACTS § 296 (Tent. Draft No. 10 1975) for resolution of the question of which party bears the risk of a

mistake as to an assumption underlying a contract. The first two subsections of § 296 are clearly not controlling in the case at bar.[13] Accordingly, it is upon the catch-all phrase, § 296(c), that the Court relies. That section provides the Court with the power to allocate the risk of mistake "on the grounds that it is reasonable in the circumstances to do so." *Id.*

The circumstances of the case *sub judice* warrant allocating to Rich the risk of a mistake as to the legality of the Rich—Government Agreement. Firstly, Rich was more familiar with the Agreement than Heyl & Patterson. Moreover, Rich had a greater incentive, which existed over a longer period of time, to verify the Agreement's legality. Most importantly, however, is the fact that Article 6 of the Rich—Heyl & Patterson Contract provides for Rich to make progress payments for "materials and equipment suitably stored at the site." This expression as to the timing of payments of contract sums suggests that simultaneously with Rich incurring liability for progress payments was transferred the risk that the preliminary work represented by those payments would be rendered worthless. Still another ground for allocating the risk to Rich is Rich's option in the Agreement with the Government to do the work itself and eliminate the Government completely. The option clause is intended to give Rich flexibility in the event problems arose during the pendency of the Agreement. Although the illegality of the Agreement prohibited Rich from exercising its option, the existence of the option implies that it was Rich who would bear the risk of difficulties interfering with fulfillment of the Agreement. Thus, the Court concludes that Rich, not Heyl & Patterson, assumed the risk of illegality of the Rich—Government Agreement and, therefore, that Heyl & Patterson satisfies all the requirements of § 294(1).

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[13] Section 296(a) discusses express allocations of a risk. Section 296(b) requires that the parties had been aware of a contingency but consciously ignored allocating the risk.

Accordingly, the Court must address the question of the appropriate relief under § 294(2):

> In determining the effect of the mistake on the agreed exchange of performances, account is taken of any relief available by way of reformation, restitution, or otherwise.

Comment to § 294(2) refers to § 297 for reformation and § 300 for restitution. Reformation is clearly inappropriate in the case at bar since the illegality problem does not result from a contractual failure to express the parties' agreement on the issue. *See* § 297. Restitution is also inapplicable since Heyl & Patterson's activities did not "confer a benefit" upon Rich. *See* § 384, Comment a (Tent. Draft No. 14 1979) ("a party's expenditures in preparation for performance that do not confer a benefit on the other party do not give rise to a restitution interest."); § 384, illustration 2. However, Comment b to § 300 provides that "(a) party may also have a claim that goes beyond mere restitution and includes elements of reliance by the claimant." It is, therefore, Heyl & Patterson's reliance interest that will form the basis for any recovery of damages.

C. FRUSTRATION OF PURPOSE

At this juncture, it is worthwhile to discuss the frustration of purpose analysis Rich stressed as the legal basis for its complete discharge from liability to Heyl & Patterson. The Court previously rejected the underlying assumption of this theory, that at the time Rich entered the contract, it had no reason to know of the Rich—Government Agreement's illegality. Yet, even if the Court were to adopt Rich's analysis and hold that Restatement §286(2) on Existing Impracticality or Frustration governs the case at bar, Heyl & Patterson would be entitled to the identical relief granted pursuant to the §292 mistake approach.

Thus, contrary to the conclusion reached by Rich, application of the law of frustration of purpose yields recovery for Heyl & Patterson.

Rich's reasoning is correct as far as it goes. We begin with comment a to §286:

> Where a party has partly performed before discovery of the impracticality or frustration, he may claim relief including restitution under the rules stated in §265 and prospective Chapter 16. See illustration 5 and §292(1).

The first option, §265 (Tent. Draft No. 8 1973), involves Part Performances as Agreed Equivalents. Rich correctly deduces that §265 does not aid Heyl & Patterson since the construction contract at issue is a single entity and the progress payments to Heyl & Patterson were not intended to represent completion of "corresponding pairs of part performances." *See id.,* Comment d. Rich is also on target as regards the second option, restitution as mentioned in §292(1). As previously established, restitution is inappropriate because the work performed by Heyl & Patterson did not "confer a benefit" upon Rich. *See* §384, Comment a (Tent. Draft No. 14 1979).

The fault with Rich's analysis is that it concludes at this point, assuming that restitution or part performance are the only remedies available to Heyl & Patterson. However, even a cursory reading of § 292(1), "either party may have a claim for relief *including* restitution....," (emphasis added) reveals that other remedies are available. In fact, Comment b to §292(1) specifically mentions that "(i) [sic] a proper case recovery may go beyond mere restitution and include elements of reliance by the claimant even though they have not benefited the other party." This is precisely such a case despite Rich's convenient ommission [sic] of the fact that Heyl & Patterson might have a reliance interest.

D. NECESSITY OF BUILDING PERMIT

Prior to reaching the damage issue, the court must address Rich's remaining arguments against recovery for partial performance. The only one meriting discussion[14] is the defense that a precondition to Heyl & Patterson's right to progress payments was fulfillment of Heyl & Patterson's contractual obligation to obtain a building permit. Heyl & Patterson denies that it was obligated to obtain a permit as a precondition to reimbursement for expenses in mobilizing a work force and purchasing materials. However, before dissecting the scope of the reimbursement obligation, the Court must determine whether Heyl & Patterson had the burden of obtaining a permit in the first place.

Heyl & Patterson contends that neither of the two documents cited by Rich as the source of Heyl & Patterson's permit obligation, Form A-201 (exh. R-8A) and the specifications (exh. R-4), were ever made a part of the September 5, 1974 contract. Mr. Strack testified that as a matter of longstanding custom Rich always utilizes a Form A-201 with a standard A-101 contract such as the September 5th contract. Mr. Goddard, a vice-president of Heyl & Patterson, testified that this was Heyl & Patterson's first experience with the A-101 standard contract. But Mr. Gerrits, an expert witness, stated that it was customary in the industry to list all documents incorporated into a contract. Thus, since Form A-201 is not referred to in Article 8 of the Contract, the provision listing all documents incorporated by reference, it cannot be considered part of the contract. This conclusion is buttressed by the fact that although each page of the contract is initialed by the parties, no portion of the Form A-201 is initialled.

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[14] There are two other defenses. Firstly, Rich maintains that RESTATEMENT (SECOND) OF CONTRACTS § 288 (Tent. Draft No. 9 1974) justifies withholding of progress payments. Yet § 288 is addressed solely to discharge of Rich's future obligations; it in no way suggests that Rich would not be liable to reimburse Heyl & Patterson for past efforts. Rich's final defense, that Heyl & Patterson requested progress payments for materials not in compliance with contract documents, will be discussed in the damage section.

A similar problem arises with the specifications since they too were not referred to in Article 8. In contrast to Form A-201, however, the parties signed the specifications and each page is initialled. Moreover, both Mr. Strack and Mr. Rich testified that the specifications were part of the contract. However, Mr. Thompson, Heyl & Patterson's man in charge of the project at the time, states that the specifications could not have been included since they were still subject to discussion after September 5, 1974. In support of this position, both Mr. Thompson and Mr. Gerrits testified that the contract could have been negotiated solely on the basis of preliminary drawings (exh. R-3) and without reference to the specifications. Yet, such negotiations seem improbable to the Court. Furthermore, Mr. Thompson was unable to cite any difference between the specifications he utilized prior to September 5, 1974 and the ones allegedly incorporated into the contract.

In addition, Mr. Gerrits conceded that if he, as a contractor, received specifications with a cover letter indicating the developer mistakenly considered them to be a finalized portion of a contract, he would immediately challenge that assumption as a matter of normal custom in the industry. But Heyl & Patterson did not protest when it received exhibit HP-7, a letter dated September 14, 1974 containing the following statement:

> Enclosed find copies of 2 letters dated September 14, 1974 to Government of the Virgin Islands and 2 sets of drawings and specifications for your contract file.

Thus, the Court can infer that Heyl & Patterson did consider the specifications to be part of the contract. Accordingly, after evaluating all the circumstances, the Court concludes that the specifications (exh. R-4) were included in the September 5, 1974 contract and, therefore, Heyl & Patterson had the duty of obtaining a building permit as stated in paragraph 1a.46.1 of the specifications.

The ultimate question, however, is whether Heyl & Patterson's obligation is a precondition to receiving progress payments. Certainly, Article 6 of the Contract, the section describ-

ing progress payments, in no way conditions Rich's duty to make payments on the acquisition of a permit. Rich argues, however, that the necessity of a permit must be read into Article 6 since without one, it would be unreasonable for a contractor to mobilize workers and order materials. Nevertheless, Mr. Gerrits and Mr. Thompson both testified persuasively that in the context of a lump-sum contract, inflationary times and a penalty provision for delay it is customary and foreseeable for Heyl & Patterson to take such actions. Heyl & Patterson's conduct appears even more reasonable because f the September 14, 1974 notice to proceed sent by Rich (exh. HP-7). Accordingly, the Court does not construe the contract to condition the making of progress payments upon the acquisition of a building permit.

E. DAMAGES

As stated above, Heyl & Patterson is entitled to damages based on its reliance interest:

> As an alternative to the measure of damages stated in §361, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any net loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.

RESTATEMENT (SECOND) OF TORTS §363 (Tent. Draft No. 14, 1979).

Two factors complicate the computation of Heyl & Patterson's damages. Firstly, although Heyl & Patterson has submitted extensive evidence of its expenditures, it has put minimal effort into demonstrating how that evidence is represented in its summary tables in exhibit HP-108. This inadequacy, in combination with the fact that the burden of proving damages in [sic] on Heyl & Patterson has prompted the Court to resolve imprecise data in favor of Rich. Secondly, the determination is intricate because the Court has found it essential to make numerous adjustments to Heyl & Patterson's damage demand.

As a preliminary matter, since adjustments were necessary the Court found it helpful to allocate freight charges and excise taxes to the appropriate expenses rather than to make separate awards for those items. Based on pages 10-11 of exhibit HP-108 and the exhibits referred to therein, the Court computed the following amounts:[15]

STEEL:	Cost	$ 88,368.73
	Freight	18,000.00
	Tax	2,790.00
		$109,158.73
MAJOR MATERIALS: (except steel)	Cost	$103,829.51
	Freight	23,000.00
	Tax	3,280.00
		$130,109.51
MAJOR EQUIPMENT:	Cost	$ 72,565.21
	Freight	8,000.00
	Tax	2,290.00
		$ 82,855.21

Since plumbing materials, the miscellaneous materials and equipment were apparently purchased in St. Thomas, there are no freight charges or excise taxes for those items.

The first adjustments to Heyl & Patterson's damage request relates to the steel rebars. As had already been established, the costs of the steel including freight and tax is $109,158.73. From that price must be deducted the amount Heyl & Patterson was able to recover from resale, $41,501.68. Thus, the actual amount claimed by Heyl & Patterson for the steel is $67,657.05. Rich challenges this claim because the specifications require grade 50 steel and all the steel ordered by Heyl & Patterson was grade 40.

Rich argues strenuously that since the grade of the steel indicates its strength, the steel ordered by Heyl & Patterson is

[15] Calculations for excise taxes are rounded off to the nearest ten. Calculations for freight charges are rounded off to the nearest thousand.

unacceptable and, therefore, no reimbursement by Rich is warranted. The testimony of Michael Fiorello, a construction expert, and Peter Brill, the architect, is clear that grade 40 is not an interchangeable substitute for grade 50. However, no witness for Rich was able to go one additional step and state that grade 40 steel was useless for the job.

For Heyl & Patterson, Floyd Thompson, the supervisor, testified that he thought the grade 40 steel could be utilized without any problem. Similarly, Dan Gerrits, a construction expert, testified that grade 40 is the standard steel utilized in the Virgin Islands. To buttress its contention that the steel was satisfactory Heyl & Patterson points out that the billings for the steel delivered to Rich stated the grade, but Rich never objected.

The Court now finds that while the steel was not of the grade specified it could, and in all likelihood would, have at least partially been utilized on the job. The Court simply finds it likely that the parties would have used a significant amount of the steel. Of course, Rich's witnesses suggested that substitution would be difficult and would involve extensive revisions in design. Moreover, it is probable that not all of the grade 40 steel could be utilized regardless of any modifications. Accordingly, the Court finds that Heyl & Patterson is entitled to reimbursement for only 50% of the cost of the steel or $33,828.53.

The next adjustment made by the Court involves the major equipment category. Including freight and taxes, Heyl & Patterson requests $82,855.21. Rich rightly criticizes Heyl & Patterson for its mitigation efforts in attempting to sell equipment. In fact, much of Heyl & Patterson's conduct in terms of resale was ineffectual since it insisted on selling most items at full cost plus freight and taxes. In addition, it let the resale process drag on for years so that items became outdated or destroyed by rust and moisture. The folly of Heyl & Patterson's efforts is illustrated by the fact that when it had an incentive to discount prices and sell rapidly, such as when it sold $60,000 worth of products during the two months immediatley [sic] preceeding [sic] trial, it was able to sell significant quantities.

Specifically as to the major equipment, Heyl & Patterson's only success was the sale of a concrete pump for $9,100.00 which was originally purchased for $18,258.57. As to the remaining $64,596.64 in equipment, however, Heyl & Patterson obtained only $3,000 in sales or use value. The Court views this figure as unacceptably low. Firstly, items included in equipment, such as trucks, major office supplies and hardware, were probably the most marketable of the entire inventory. Secondly, the equipment was readily usable on Heyl & Patterson's side projects. Thus, the Court finds that 50% of the value of the major equipment could have been recovered. Accordingly, Heyl & Patterson's damage demand, exclusive of the concrete pump, will be reduced by 50% of the $64,596.64 ($32,298.32) less the $3,000.00 it actually sold. Thus, the award will be reduced by $29,298.32 to $41,456.89.

The third adjustment to Heyl & Patterson's damage demand relates to payroll. Heyl & Patterson requests $65,889.84 representing payments for workers employed by two independent contractors, Queally Construction Company and Joe's Construction Company. Initially, since Heyl & Patterson admits that the project was dead as of the August 14, 1975 meeting between Governor King and Rich, no payroll expenses after August 1975 will be allowed. Thus, the entire payroll of Joe, $2,253.13 and a portion of the Queally payroll, $1,694.33, must be eliminated.

Furthermore, payroll expenses from February 1, 1975 through August 31, 1975 are also suspect. Heyl & Patterson concedes that the Queally workers were generally idle except for the construction of the warehouse, security hut and a well at the beginning of the job. Nonetheless, Heyl & Patterson maintains that it was correct in keeping the workers on the payroll through August. According to Heyl & Patterson, layoffs would have made it impossible to mobilize a work force quickly enough to comply with contractual deadlines if a proceed order was suddenly issued by Rich.

There are, however, two fallacies with this rationale. Firstly, since Heyl & Patterson was to some extent informed of

Rich's negotiations with the Government, a decision to proceed would not come as a total surprise. Secondly, Heyl & Patterson repeatedly points to the construction work downturn in 1974—1975 to justify its lack of success in mitigating damages by selling off supplies. Yet this same fact also rebuts Heyl & Patterson's argument on layoffs because it indicates that there would be an ample work force readily available should the project be rejuvenated. Consequently, Heyl & Patterson's payroll request must be reduced.

Since Floyd Thompson testified that by the end of January, 1975 he knew the project was at least temporarily dead, the Queally workers should have been dismissed at that point. In fact, Thompson testified that by late January he had stopped all shipments of supplies from off-island. Hence, Heyl & Patterson is not entitled to the payroll expenses of $26,050.94 for the Queally subcontract between February 1, 1975 and August 31, 1975.

While on the subject of payroll, Floyd Thompson's $24,000 salary from September 1, 1974 to August 31, 1975 also merits discussion. In contrast to the subcontract employees, it was reasonable for Heyl & Patterson to keep Thompson, Heyl & Patterson's top man at the site, on salary through August, 1975. Someone had to be present to supervise the site, conduct liquidation of supplies and be ready for the contingency of a renewal of the project. Nevertheless, it is fair to assume that 25% of Thompson's time was spent supervising Heyl & Patterson's other work on St. Thomas and on other activities unrelated to the Nazareth Project. Accordingly, Heyl & Patterson will recover only $18,000 out of Thompson's $24,000 salary for the year September 1, 1974 to August 31, 1975.

A fourth damage adjustment is appropriate for Heyl & Patterson's bill of $9,506.74 for miscellaneous services. These include what might be described as overhead expenses: electricity, telephone, photocopying and gasoline. Clearly, a significant portion of these should be allocated either to Heyl & Patterson's side projects or to general operating expenses.

Consequently, Heyl & Patterson will be awarded only 50% of this amount or $4,753.37.

The Court finds the remaining damages requested by Heyl & Patterson in exhibit HP-108 to be justified:

1) Major Materials (except steel)	$130,109.51
2) Plumbing Materials	66,907.01
3) Miscellaneous Materials Equipment....	12,373.43
4) Site Work	9,828.30

Heyl & Patterson's mitigation efforts relative to the first three materials outlays were satisfactory since it sold and used these materials for a setoff of $121,096.72 out of the total value of $209,489.95. Of course, the $121,096.72 representing sales and use of materials will reduce Heyl & Patterson's final damage award by a corresponding amount. Rich questions the plumbing materials expense since Heyl & Patterson ordered and shipped enough for the entire project rather than as needed. Nonetheless, the Court finds Heyl & Patterson's actions reasonable since cost savings could be achieved through economies of scale.

There remain two additional adjustments to Heyl & Patterson's damages which must be computed. One is necessary to account for the value of items still remaining in the warehouse which have not been sold or utilized by Heyl & Patterson. Douglas Crotwell, the warehouse manager, testified that the value of the items remaining as of the date of trial in May, 1979 was $20,000. Edmund Strack inventoried the goods in the warehouse on March 16, 1979 and valued them at $80,000. (See exh. R-33). Yet, Strack's estimates were apparently based on purchase price rather than present value and also did not account for items sold between March and the date of trial. Hence, Crotwell's $20,000 figure is adopted by the Court.

Heyl & Patterson maintains that even the reduced figure of $20,000 is too high. According to Mr. Tolan, it would be more expensive to sell the remaining goods than they are worth.

Moreover, Tolan states that Heyl & Patterson will not pursue any additional contracts in the Virgin Islands so that it cannot utilize the remaining goods here and they are not worth shipping elsewhere. Nonetheless, the $20,000 figure will stand. To the extent Heyl & Patterson is stuck with worthless materials it is its own fault since its efforts to sell the goods were tardy and somewhat ineffectual.

A final adjustment to Heyl & Patterson's recovery is appropriate to account for Heyl & Patterson's use in its side projects of the warehouse, security hut and any other facilities at Nazareth not previously mentioned. Since the side projects were minor as compared with the size of the Nazareth project, only a small sum is warranted. Accordingly, the Court will reduce Heyl & Patterson's damage request by an additional $5,000.

In conclusion, the following list summarizes Heyl & Patterson's damages:

Item	Billing Amounts
Steel	$109,158.73
Major Equipment	82,855.21
Payroll	65,889.84
Thompson Salary	24,000.00
Miscellaneous Services	9,506.74
Major Materials (except steel)	130,109.51
Plumbing Materials	66,907.01
Miscellaneous Materials & Equipment	12,373.43
Site Work	9,828.30
Subtotals	$510,628.77

Adjustments		Reimbursement
Resale	$ 41,501.68	
Wrong Grade	33,828.53	
		$ 33,828.53
Resale	12,100.00	
Failure to Mitigate	29,298.32	
		41,456.89
Post 8/31/75	3,947.46	
Post 1/31/75	26,050.94	
		35,891.44
Side jobs	6,000.00	
		18,000.00
Side jobs	4,753.37	
		4,753.37
		130,109.51
		66,907.01
		12,373.43
		9,828.30
	$157,480.30	$353,148.48
Final Adjustments:		
Sale or Use of Materials (except steel & major equipment)	121,096.72	
Materials Remaining in Warehouse	20,000.00	
Use of Facilities on Side Jobs	5,000.00	
		(146,096.72)
	$303,577.02	$207,051.76

F. Prejudgment Interest

RESTATEMENT (SECOND) OF CONTRACTS § 368 (Tent. Draft No. 14 1979) provides for the payment of interest as damages to an injured party to compensate for the inability to use a promised performance from the date it was due:

> § 368. INTEREST AND DAMAGES.
>
> (1) If the breach consists of a failure to pay a definite sum in money or to render a performance with fixed or ascertainable monetary value, interest is recoverable from the time for performance on the amount due less all deductions to which the party in breach is entitled.
>
> (2) In any other case, such interest may be allowed as justice requires on the amount that would have been just compensation had it been paid when performance was due.

Heyl & Patterson's claims against Rich fall within the scope of § 368. Rich breached the contract by failing to make progress payments which were clearly due. *See Id.* Comment b.[16] Heyl & Patterson is, therefore, entitled to interest represent-

---

[16] The contract between Rich and Heyl & Patterson, exhibit HP-1, provides as follows:

> ARTICLE 6
>
> PROGRESS PAYMENTS
>
> Based upon Applications for Payment submitted to the Architect by the Contractor and Certificates for Payment issued by the Architect, the Owner shall make progress payments on account of the Contract Sum to the Contractor as provided in the Conditions of the Contract as follows:
>
> On or about the 25th day of each month 90% of the proportion of the Contract Sum properly allocable to labor, materials and equipment in the Work and 90% of the portion of the Contract Sum properly allocable to materials and equipment suitably stored at the site or at some other location agreed upon in writing by the parties, up to the 25th day of that month, less the aggregate of previous payments in each case; and upon Substantial Completion of the entire Work, a sum sufficient to increase the total payments to 90% of the Contract Sum, less such retainages as the Architect shall determine for all incomplete Work and unsettled claims.
>
> 10% retention shall be held until a unit is sold or for two months whichever is a shorter period after completion of a unit.

ing the use it could have made of the money had it been timely paid. In fact, § 368, Comment c specifically refers to installments due on a construction contract.

The difficulty with awarding prejudgment interest is that § 368(1) requires that the amount due be definite. Heyl & Patterson argues that its monthly billings to Rich from November, 1974, to April, 1975, are sufficiently definite. Heyl & Patterson contends that Rich can then raise whatever deductions from the billings are warranted. Unfortunately, Heyl & Patterson's methodology is theoretically sound but tremendously burdensome. Accounting for all of the adjustments made by the Court as well as the timing of the purchases and selling off of items is an immense task.

The Court finds it preferable to proceed under § 368(2) which allows for the payment of interest on a generalized estimate of "the amount that would have been just compensation had it been paid when performance was due." Thus, judicial discretion will supplement the difficulties the parties may have encountered in establishing a proper tender by Rich. Yet, the essence of § 368 is still accomplished since Heyl & Patterson's claims are of the type addressed by that section. *See* § 368, illustration 9. The alternative would be a windfall to Rich due to the five year delay between the breach of contract and judgment.

The Court will determine the sum upon which prejudgment interest will be granted based upon the summary of Heyl & Patterson's damages. Hence, the Court's analysis begins with the final damage figure of $207,051.76. From that amount the following reimbursement calculations will be deducted:

Steel	$33,828.53
Major Equipment	41,456.89
Thompson Salary	18,000.00
	$93,285.42

The controversy over the grade of the steel signifies that there was never a sufficiently precise amount prior to trial to have

warranted a tender by Rich. No allowance will be made for major equipment because Heyl & Patterson apparently would not bill Rich for that expense until the completion of the contract. Finally, Thompson's salary is excluded because it was in the nature of a general expense not to be included in the monthly billings. However, the Court finds that the remaining billings totalling $113,766.34 were sufficiently definite to entitle Heyl & Patterson to prejudgment interest in light of all the circumstances.

The date after which prejudgment interest will be computed is April 30, 1975. At that point Rich had all the billings it would receive from Heyl & Patterson. Furthermore, it is close to the midpoint between the initiation of the contract and the final death blow of the meeting in August, 1975. In addition it is a logical midpoint of the time during which Heyl & Patterson was actually paying its expenses in contrast to billing them. Also, it is in between the time Heyl & Patterson incurred its expenses and the time Heyl & Patterson should have accomplished a mitigation of its damages by selling off its inventory.

Lastly, interest will be computed at the rate of 9% per annum. According to § 368, comment a, "(i)t is payable without compounding at the rate, commonly called the legal rate, fixed by statute for this purpose." *See* 11 V.I.C. § 951(a)(4) (Supp. 1977). Accordingly, prejudgment interest will be awarded in the amount of $.

A proposed Judgment will be submitted to the Court by Heyl & Patterson.

Dated: May 23, 1980.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

HEYL & PATTERSON INTERNATIONAL, INC. *vs.* F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC. and F. D. RICH HOUSING CORP.	Nos. 80-2749 and 81-1193 (D.C. Civil No. 75-785)
F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC., as assignee of F. D. Rich Housing of Puerto Rico, Inc. *vs.* GOVERNMENT OF THE VIRGIN ISLANDS	(D.C. Civil No. 76-62)

F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC., and F. D. RICH HOUSING CORP., Defts., Third-Party-Pltfs. in Civil No. 75-785 and F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC., Pltf. in Civil No. 76-62, Appellants

ON APPEAL FROM THE DISTRICT COURT OF THE VIRGIN ISLANDS, DIVISION OF ST. THOMAS AND ST. JOHN

Present: SEITZ, *Chief Judge* and VAN DUSEN and HIGGINBOTHAM, *Circuit Judges*

JUDGMENT

These causes came on to be heard on the records from the District Court of the Virgin Islands, Division of St. Thomas and St. John and were argued by counsel on July 14, 1981.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgments of the said District Court in D.C. Civil No. 75-785 and D.C. Civil No. 76-62, both entered July 14, 1980, be, and the same are hereby affirmed. Costs taxed against appellants.

ATTEST:

/S/ SALLY MRVOS
Clerk

October 19, 1981

APPENDIX D

FEDERAL RULES AND TERRITORIAL STATUTES INVOLVED

Fed. R. Civ. P. 8(c):

In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, and any other matter constituting an avoidance or affirmative defense. When a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the court on terms, if justice so requires, shall treat the pleading as if there had been a proper designation.

Fed. R. Civ. P. 12(b):

Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, he may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to

dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Fed. R. Civ. P. 15(a):

A party may amend his pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, he may so amend it at any time within 20 days after it is served. Otherwise a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires. A party shall plead in response to an amended pleading within the time remaining for response to the original pleading or within 10 days after service of the amended pleading, whichever period may be the longer, unless the court otherwise orders.

Title 29, Virgin Islands Code, § 191n:

Cost limitations.

(a) No dwelling shall be erected by the Government at a cost of more than $25,000 exclusive of the proportional cost of the land.

(b) The minimum selling price for a dwelling shall be a sum at least equal to the Government's acquisition cost plus the cost of any additions and improvements.

Title 33, Virgin Islands Code, § 3101:

Expenditures or contracts in excess of appropriations.

No officer or employee of the Virgin Islands shall make or authorize an expenditure from, or create or authorize an

obligation under any appropriation or fund in excess of the amount available therein; nor shall any such officer or employee involve the government in any contract or obligation for the payment of money for any purpose, in advance of appropriations made for such purpose, unless such contract or obligation is authorized by law.

Act No. 3088, 1971 V.I. Session Laws 313, § 1:

Notwithstanding any other general or specific law to the contrary, no housing project, housing development or housing unit shall be constructed under the jurisdiction of the Department of Housing and Community Renewal or the Virgin Islands Housing Authority unless a "housing development plan" therefor is first adopted and submitted to the Governor and the Legislature for approval. The housing development plan required by this Act shall be a statement by words, maps, graphics and other appropriate forms of the overall proposed housing project. The plan shall include, but not be limited to the following:

(1) the location and sizes of all structures to be constructed on the site;

(2) external appearance of the development;

(3) the lines of streets, roads or other public ways proposed for construction or alteration;

(4) the line and/or location of sidewalks, street lights, easements for public utilities and sewage treatment facilities;

(5) the sites of proposed parks, recreational areas and other open spaces;

(6) the sites, if any, for proposed schools, police and fire substations and other public buildings;

(7) areas adjoining the site recommended to be acquired for any public purposes; and

(8) the sites for commercial areas.

CERTIFICATE OF SERVICE

This is to certify that three copies of the foregoing were mailed, first-class postage prepaid, to Edward A. Wascoe, Esquire, Assistant Attorney General, Department of Law, P.O. Box 280, St. Thomas, Virgin Islands 00801, this 15th day of January, 1982.

.....

Attorney

Opposition

Office - Supreme Court, U.S.
FILED
FEB 18 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1340

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC.

and

F. D. RICH HOUSING CORP.,
Petitioners,

v.

GOVERNMENT OF THE VIRGIN ISLANDS,
Respondent.

BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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IN THE

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OCTOBER TERM, 1981

No. 81-1340

F. D. RICH HOUSING OF THE VIRGIN ISLANDS, INC.

and

F. D. RICH HOUSING CORP.,

Petitioners,

v.

GOVERNMENT OF THE VIRGIN ISLANDS,

Respondent.

BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

STATEMENT OF THE CASE

The present action between F. D. Rich Housing of the Virgin Islands, Inc. and F. D. Rich Housing Corp. (hereinafter "Rich" or "F. D. Rich") petitioner, and the Government of the Virgin Islands of the United States of America (hereinafter "Government"), respondent, arises out of a contract signed by representatives of the two parties on October 1, 1973. The agreement called for the construction by Rich of some 320 middle income dwellings. Rich as developer engaged Heyl & Patterson International, Inc. as contractor for the actual construction of the housing. When the project failed to get off the ground, Heyl & Patterson International sued Rich. In early 1976 Rich

named the Government in both a Complaint and a Third-Party Complaint.

Several months before trial in January 1979 the Government moved to amend its Answer to add the affirmative defense of illegality (A. A.[1] at 34a). It indicated that this defense was based on the failure of the October 1, 1973 agreement to be supported by both adequate appropriation of the Virgin Islands Legislature and proper lawful authority (A. A. 51a f). The District Court granted the Government leave to so amend noting that no delay was likely to result in allowing the amendment as only legal issues requiring minimal trial preparation were involved (A. A. 53a f).

The matter was tried in May of 1979. At the beginning of trial the Government's counsel opened repeating its position that the contract was unenforceable as illegal in that it failed to meet either of the conditions of 33 V. I. C. Section 3101. It then specified that not only was the contract unsupported by prior adequate appropriation but that it was also unauthorized by law in that it failed *inter alia* to comply with Act No. 3088, Virgin Islands Session Law of 1971, p. 313 and Title 29 Virgin Islands Code Section 191n (A. A. 132a-136a). Rich objected at this point on the grounds that raising Act No. 3088 and 29 V.I.C. 191n were new defenses which had not been raised earlier (A. A. 138a). The Government countered that no new defense was raised indicating that under 33 V.I.C. Section 3101 a contract had to be authorized by law if no prior adequate appropriation existed. The failure to comply with Act No. 3088 and 29 V.I.C. Section 191n, the Government asserted, was indicative that the agreement was unauthorized by law (A. A. 316a f).

After trial the District Court allowed the parties to address the issue of the timeliness of raising Act No. 3088 and 29 V.I.C. 191n as well as other issues in post trial

[1] A.A. refers to the Appellant's Appendix in the Court of Appeals.

memoranda. After reviewing the memoranda the trial court rendered its opinion on May 23, 1980. The District Court found in favor of the Government. It determined that prior legislative appropriation was inadequate to support the contract, no housing development plan as required by Act No. 3088 had been submitted for legislative approval and the contract itself violated 29 V.I.C. Section 191n, Petitioner's Brief B1 ff). In regard to the propriety of considering the Government's entire illegality defense the court stated:

> Certainly, a party is able to amend its pleadings at any time up to, during, and even after trial. C. Wright & A. Miller, FEDERAL PRACTICE AND PROCEDURE: Civil § 1488 at 438 (1971). Thus, the Government was free to move to amend its answer at any time during the trial. That is precisely what the Government did when it raised its alternative illegality defenses in its opening statement. The sole limitation upon the Court's "liberal" discretion to grant leave to amend, even at that late date, is an affirmative showing the Government "has been guilty of delay in requesting leave to amend and, as a result of delay, the proposed amendment, if permitted would have the effect of prejudicing . . ." Rich. Id. at 439. Aside from a bit of puffing, such a showing, especially as to the requirement of prejudice from the delay, is conspicuously absent from Rich's memoranda. Accordingly, all affirmative defenses asserting illegality of the Agreement will be examined by the Court. (Petitioner's Brief at B6-B7).

Rich appealed contesting the findings of the trial judge as set out above. Only in petitioner's Brief for Appellants submitted to the United States Court of Appeals for the Third Circuit March 4, 1981, did Rich attempt to detail objections to the trial court's consideration of the Government's illegality defenses. Prejudice which heretofore was not mentioned by Rich was raised for the first time when

Rich argued that the trial court's grant of leave was an abuse of discretion.[2]

The Third Circuit considering this argument looked at all the bases for denial of leave to amend as provided in *Foman v. Davis*, 371 U.S. 178 (1962) undue delay, bad faith or dilatory motive, failure to cure, prejudice, futility, etc. Relying on these criteria it specifically found that the trial judge did not abuse its discretion in allowing amendment as it found no acts of deliberate deception, flagrant abuse or proven prejudice (Petitioner's Brief at A9-A13). Judge Higginbotham noted in his opinion:

> Though Rich argued that the opening statement of the Government constituted an unexpected change in theory which Rich, because of time restraints, was unable effectively to meet during trial, Rich failed to seek a continuance to enable it to offer such rebuttal evidence or to present such evidence of prejudice in post-trial briefing. Even to this hour appellant has not indicated what evidence it would have presented in view of the Government's alleged change in theory. (Petitioner's Brief A12-A13).

Upholding the District Court, a unanimous Third Circuit panel held that the contract between Rich and the Government was invalid and unenforceable for the reasons given by the trial judge.

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[2] Petitioner did not raise the matter of who had the burden of showing why an amendment should or should not be allowed. This question is raised for the first time in Rich's petition for a Writ of Certiorari.

ARGUMENT

I. THE COURT OF APPEAL'S SANCTION OF THE TRIAL COURT'S EXERCISE OF DISCRETION UPHOLDS THE SPIRIT AND SUBSTANCE OF THE FEDERAL RULES OF CIVIL PROCEDURE

Petitioner Rich insists that this matter brings into question the efficacy of two rules of federal civil procedure, Rule 8 and 15. Rule 8(c) specifies that the defense of illegality must be set forth affirmatively. Rule 15 provides the procedure to amend pleadings. Petitioner contends there can only be rigid adherence to these procedures. A reading of these rules indicates otherwise. Both rules are tempered with provisioning allowing for construction in such a way that matters are resolved on their merits rather than by skill or happenstance of pleading. Additional emphasis against too technical an application is set out in the very first rule.

Rule 8(c) must be read in conjunction with rule 8(f) mandating that pleadings shall be construed "as to do substantial justice." A unanimous court in *Conley v. Gibson*, 355 U.S. 41, 48 (1957) stressed this point. The mandate is reinforced by Federal Rules of Civil Procedure 1 which *inter alia* directs that the rules be constructed with the same goal in mind, the just determination of cases.

The procedures established in Rule 15a and b likewise cushion parties from the harsh rigidity espoused by Rich. "Amendment is to be freely given when justice requires," Rule 15(a) provides. Parallel to that is the wording of Rule 15(b) allowing change when "the presentation of the merits of the action will be served thereby . . ." The entire thrust of the rules is against inflexible and unyielding interpretation which Rich favors. "The federal rules are designed to discourage battles over mere form and to sweep away needless procedural controversies that either delay a trial on the merits or deny a party his day

in court because of technical deficiencies." 4 Wright and Miller, Federal Practice and Procedure § 1029.

The metier of the trial judge is to balance the rule's requirement of notice and predictability in the practice with the need for resolution of cases on the merits. In this case the trial court acted well within the boundaries of its allowable discretion as established by the rules and decisional law interpreting them in its full examination of the case presented. Not only did the trial judge believe he was acting within the allowable margin but the three judges reviewing his course concurred with his judgment. As a review of the cases indicate appellate courts have allowed trial judges the widest discretion in allowing the amendment of pleadings. It is only when the trial judge exceeds the broad parameters set down by case law that the trial court is reversed.

II. THE COURT OF APPEAL'S APPROVAL OF THE DISTRICT COURT'S EXERCISE OF DISCRETION IN CONSIDERING THE COMPLETE ILLEGALITY DEFENSE WAS WELL FOUNDED IN CASE LAW AND SERVES THE INTERESTS OF JUSTICE BY FACILITATING DECISIONS ON THE MERITS

The Third Circuit in finding that the Government's amendment of its affirmative defenses were proper looked to the guidelines of this Court in *Foman v. Davis*, 371 U.S. 178, 182 (1962) and *Zenith Radio Corporation v. Hazeltine Research, Inc.*, 401 U.S. 321, 330 (1971), Petitioner's Brief at A9. Petitioner asserts that the Third Circuit has ignored the *Foman* decision and has taken *Zenith* out of context. A reading of both cases may shed some light on the Third Circuit's ruling.

The *Foman* decision concerns a trial court's denial of leave to amend pleadings. Plaintiff had sought to introduce an alternate theory of recovery after the trial court had dismissed the complaint for failure to state a claim *Foman, Ibid*, 179-181. The record apparently did not

reveal the reasoning of the District Court in denying the leave to amend. This Court instructed that claims should be resolved on their merits, *Ibid* 182. Its specific guidelines are worthy of being repeated here:

> In the absence of any apparent or declared reason—such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.—the leave sought should, as the rules require, be 'freely given.' Of course, the grant or denial of an opportunity to amend is within the discretion of the District Court, but outright refusal to grant the leave without any justifying reason appearing for the denial is not an exercise of discretion; it is merely abuse of that discretion and inconsistent with the spirit of the Federal Rules. *Ibid.*

Thus, in a 7 to 2 decision the ruling below was reversed. The two remaining Justices in a separate opinion reasoned that the writ of certiorari should have been dismissed as improvidently granted as the denial of the motion to amend (as well as the disposition of a motion vacate) was a matter best left with the Courts of Appeal. *Ibid*, 183.

Petitioner here asserts that the Third Circuit has ignored the teaching of *Foman* in that it relied on only one of its criteria for denial i.e. prejudice. The record will show however that both courts below regarded factors other than prejudice. (Petitioner's Brief at B6-B7 A12-A13). More important the Court in *Foman* never demanded that the trial court's discretion as to whether to grant leave to amend had to be based on the existence of all factors or what weight each factor was to be given. What this writer believes the Court was setting down was that while denial could be discretionary it could not be arbitrary and one or more of the reasons to deny such

as undue delay, bad faith or dilatory motives on the part of the party seeking amended pleadings, undue prejudice to other parties, futility of amendment or the like had to be present. The Court was not restricting the trial judge to any one reason. It was emphasizing that just cause must be given for denying the resolution of a matter on the merits.

In *Zenith, Ibid* this Court appears to have refined its posture in regarding the factors stated in *Foman*. In that case a special importance was ascribed to the role of prejudice to the non-moving party when considering the allowance of an amendment. There the moving party sought to assert additional defenses a year after evidence was closed and the trial judge had entered a preliminary finding of fact and conclusions, *Ibid* 324. It is unclear whether move to amend was granted or denied. This Court held that the trial judge had a firm basis for denying the amendment but that if he allowed the amendment and rejected the amended pleadings on the merits he would have also been acting properly, *Ibid* 325. Justice White writing for the Court saw that it might have been in the proper discretion of the court to have allowed the amendment in question but that in any decision the trial judge was obligated to weigh the prejudice to the non-movant, *Ibid.*

Among the authorities cited for this proposition was *United States v. 47 Bottles, More or Less*, 320 F.2d 564, 574 (3rd Cir. 1963). That case specifically set out that in ruling on an amendment under F.R.C.P. 15, the discretion of the trial judge "while quite broad is not unlimited and cannot be exercised in such a manner as to result in substantial prejudice to a party, *Ibid* 573, 574. Such prejudice in the situation in *Zenith, Ibid* this Court allowed would have been substantial. Undeniably the court looked at the delay amendment would cause, *Ibid* 329. But if as appellant contends this Court permitted rejection of the amendment on the basis of delay alone why was it

necessary for Justice Harlan joined by Justice Stewart to set out in a separate concurring opinion their belief that the trial judge could have rejected the proffered amendment for lateness alone, *Ibid* 349. But note even the two concurring justices would also look to factors beside delinquency when deciding when to permit amendments.[3]

Relying on *Foman, Supra* and *Zenith, Supra* the Third Circuit decided the District Court's ruling to hear the case on its merits. This position was bolstered by a number of other authorities: *United States v. Hougham*, 364 U.S. 310 (1960); *S. S. Silberblatt, Inc. v. East Harlem Pilot Block*, 608 F.2d 28 (2d Cir. 1979); *Skehan v. Trustees of Bloomburg State College*, 590 F.2d 470 (3rd Cir. 1978), cert. denied, 444 U.S. 832 (1979); *Cornell and Company, Inc. v. Occupational Safety and Health Review Commission*, 573 F.2d 820 (3rd Cir. 1978); *Thomas v. E. I. DuPont de Nemours & Co.*, 574 F.2d 1324 (5th Cir. 1978); *Mertens v. Hummell*, 587 F.2d 260 (4th Cir. 1977); *Bireline v. Seagondollar* 567 F.2d (4th Cir. 1977) 3 Moore's Federal Practice, ¶ 15.08 [4] at 15-85; *Goodman v. Mead Johnson & Co.*, 534 F.2d 566 (3rd Cir. 1966) cert. denied, 429 U.S. 1038 (1977); *Matlack, Inc. v. Hupp Corporation*, 57 F.R.D. 151 (E.D.Pa. 1973); *Canister Co. v. Leahy*, 191 F.2d 255, 257 (3d Cir. 1051), cert. denied, 342 U.S. 893 (1951); *Deakyne v. Commissioners of Lewes*, 416 F.2d 290 (3rd Cir. 1969).

The decision of the Third Circuit in the case at bar therefore is certainly in line with the opinions of the Supreme Court on the subject. Rich, however, suggests that this case is ripe for review in that there is little uniformity among the federal appellate courts on the subject of the allowance of amendments of pleadings. Rich

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[3] They noted that the trial court must have considered the merits of the changed pleadings sufficiently to be satisfied that a refusal to allow Hazeltine permission to raise new defenses [the proffered amendment] worked no gross inequity.

concedes there are five other circuits that approach the matter in a manner similar to the Third Circuit. These are the Fourth, Sixth, Eighth, Ninth, and Tenth: *Davis v. Piper Aircraft Corp.*, 615 F.2d 606 (4th Cir. 1980), cert. dismissed pursuant to Rule 53, 448 U.S. 911 (1980). *Estes v. Kentucky Utilities Co.*, 636 F.2d 1131, (6th Cir. 1980), *Beeck v. Aquaslide 'N' Dive Corp.*, 562 F.2d 537, (8th Cir. 1977), *Howey v. United States*, 481 F.2d 1187, (9th Cir. 1973); *R. E. B., Inc. v. Ralston Purina Co.*, 525 F.2d 749, (10th Cir. 1975) (Petitioner's Brief at 8).

In *Davis v. Piper Aircraft Corp., Supra*, the Fourth Circuit reversed a trial court's denial of leave to amend pleadings. Citing *Zenith Radio Corp., Supra*, the court found that prejudice to the non-moving party was sufficient reason to deny. "Conversely, absence of prejudice though not alone determinative, will normally warrant granting leave to amend . . . Delay alone, however, without any specifically resulting prejudice or any obvious design by dilatoriness to harrass the opponent should not suffice as reason for denial." *Davis Supra* at 613. In *Estes v. Kentucky Utility Co. Supra*, the Sixth Circuit came to a similar conclusion although the amending party had not moved to amend until forty-one months after the original answer was filed. Two and a half years after filing his complaint, the Plaintiff in *Buder v. Merrill, Lynch, Pierce, Fenner and Smith*, 644 F.2 690 (8th Cir. 1981) sought leave to amend his complaint. The trial court relying on the two and a half year delay denied this leave. Here the Eighth Circuit found an abuse of judicial discretion in that delay alone, in the absence of prejudice, is insufficient to warrant denial. *Ibid.* 694. See also *Beeck v. Aquaslide 'N' Dive Corporation, Supra* and *Chestnut v. St. Louis County Mo.*, 656 F.2d 343 (8th Cir. 1981). *Hurn v. Retirement Fund Trust of Plumbing, Etc.*, 648 F.2d 1252 (9th Cir. 1981) and *United States v. Webb*, 655 F.2d 977 (9th Cir. 1981) result in similar rulings by the Ninth Circuit Court of Appeal. See too *Howey v.*

United States, Supra, where Judge Lumbard sitting by designation found an abuse of discretion in denying leave to amend on the second day of trial. Also in the Ninth Circuit there is *Brown v. AVEMCO*, 603 F.2d 1367 (9th Cir. 1979) which in the same spirit of the above cases distinguished *Hargrave v. E. G. Willman*, 276 F.2d 948 (9th Cir. 1960) cited by Rich. Finally, in the Tenth Circuit, the Court of Appeals ruled it was an abuse of discretion not to allow the plaintiff to amend its complaint even after remand from prior appeal. Delay alone in requesting leave without prejudice did not warrant denial, *R.E.B. Inc. v. Ralston Purina Co., Supra* at 751-752.

Rich asserts that the remaining circuits look at the *Foman* criteria in the alternative and that only one factor need be present to dictate denial of an amendment. For this proposition Rich cites: *Vargas v. McNamara*, 608 F.2d 15 (1st Cir. 1979). *Glaros v. Perse*, 628 F.2d 679, (1st Cir. 1980); *S. S. Silberblatt v. East Harlem Pilot Block, Supra*; *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, (5th Cir. 1979), cert. denied, 449 U.S. 905 (1980); *Mertens v. Hummell, Supra; Doe v. McMillan*, 556 F.2d 713, (D.C. Cir. 1977), cert. denied, 435 U.S. 969 (1978).

Contrary to Rich's contention even in these circuits the discretion of the trial judge is still paramount. Neither undue delay, nor bad faith nor repeated failure to cure will *dictate* denial of an amendment with or without prejudice to the non-moving party. In none of the above cases was a grant of leave to amend reversed as an abuse of discretion because only one of the *Foman* factors existed. Indeed in all of these cases cited by Rich the trial court's denial of leave rather than a grant of leave to amend was being appealed. And indeed in all of the cases Rich cites the presence of additional *Foman* factors was always noted by the reviewing court. Mere delay rarely substantiated barring a decision on the merits.

In *Vargas v. McNamara, Supra* plaintiff sought to amend the complaint at the close of his case at trial. His

motion was denied and he appealed. The First Circuit Court of Appeals remanded the matter with instructions which include consideration of prejudice, *Ibid* 19. Again, in *Glaros v. Perse, Supra* this same court remanded for reconsideration of the trial court's denial of leave to amend. Again, the factors delay and prejudice were to be weighed in this reconsideration *Ibid* 687.

The cases in the Second Circuit are even more directly in line with the Third Circuit's posture in this area. In *S. S. Silberblatt, Supra* the trial judge denied leave finding both delay and prejudice but the reviewing court found the prejudice not substantial enough to warrant denial of leave. The trial court was reversed. Likewise, in *State Teachers Retirement Board v. Fluor Corp.*, 654 F.2 843 (2 Cir. 1981) the trial court was reversed for abusing of discretion in denying amendment without regard to prejudice in addition to delay.

At first blush *In re Beef Industry Antitrust Litigation, Supra* lends some support to Rich's proposition that delay alone is sufficient cause to warrant denial of amendment of pleadings. Yet the Fifth Circuit Court of Appeals was quick to add that the trial court's position was also supportable on the grounds of futility another of the *Foman* factors, *Ibid* 1162. More recent decisions in the Fifth Circuit display a reluctance to base denial only on tardiness in raising the new amendment or the delay which late amendment might cause. For instance in *Addington v. Farmer's Elevator Mut. Ins. Co.*, 650 F.2d 663 (5th Cir. 1981) the Court of Appeals found denial justifiable where there was a delay, which would cause prejudice and also futility. See also *Thompson v. New York Life Ins. Co.*, 644 F.2d 439 (5th Cir. 1981) 444 where prejudice is stressed and *Bamm, Inc. v. GAF Corp.*, 651 F.2d 389 (5th Cir. 1981).

Rich cites *Mertens v. Hummell, Supra* for the proposition that the Seventh Circuit also approaches the *Foman*

factors as equal alternatives. But the per curiam decision in that case found no abuse of discretion in a trial judge's denial of a party's motion to amend when the judge's decision took into consideration prejudice as well as undue delay, *Ibid* 865f. Other decisions within this circuit follow this line: *Manual v. International Harvester Co.*, 502 F. Supp. 45, 51 (N.D. Ill. 1980). *Conroy v. Datsun Ltd. v. Nissan Motor Corp. In U.S.A.*, 506 F. Supp. 1051, 1054. (N.D. Ill. 1980).

Finally, in the review of the various courts of appeals Rich suggests have positions in variance to that held by the Third Circuit we come to the Court of Appeals for the District of Columbia Circuit. Here Rich refers to *Doe v. McMillian, Supra.* In this case a class action was filed in 1971 seeking *inter alia* temporary equitable relief. The District Court dismissed the complaint and denied the restraining order. The matter then went to the circuit court on appeal and finally to this Court on a writ of certiorari. The matter was remanded to the district court and at that time plaintiffs sought to amend their complaint. This was not permitted. The circuit court found no abuse of discretion here but noted not only the thirty-eight month delay in seeking leave to amend but also the potential prejudice to the other party, *Ibid. Sinclair v. Kliendienst*, 645 F.2d 1080 (D.C. Cir. 1981) is similarly based. The trial court denied a motion to amend. While both the trial court and the reviewing court found substantial delay the Court of Appeals did not find the prejudice to the non-moving party so significant as to warrant refusal of leave to amend, *Ibid* 1085. The trial court was reversed for this denial. See also *S.E.C. v. National Student Marketing Corp.*, 73 F.R.D. 444 1977).

There is a remarkable consensus in the contemporary approach of the circuits. But even assuming *arguendo* that Rich is correct that the circuits are at odds as to the application of the *Foman* factors under any approach no abuse of the trial court's discretion can be found.

Consequently, no matter the approach the decision of the District Court as sanctioned by the Third Circuit must stand.

III. THE TRIAL COURT DID NOT DEPART FROM ACCEPTED JUDICIAL PROCEDURE

Rich contends that this Court's power of supervision is required to correct what it deems to be departure from "the accepted and usual course of judicial proceedings" by the trial court and permitted by the Third Circuit. Here Rich is arguing that it was improper for the District Court to treat the inclusion of the two statutes in the Government's opening statement as a motion to amend. The court below found otherwise on this issue. It noted that while the procedure as set forth in the rules for obtaining leave to amend should be followed, "rigid adherence to formalities and technicalities must give way before the policies underlying Rule 15," Petitioner's Brief at A11. Authority for this position is found as the Third Circuit noted in *Conley v. Gibson*, 355 U.S. 41 (1957). "The federal rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to *facilitate a proper decision on the merits*" *Ibid.* 48. Accord *Foman, Supra* 182 (emphasis supplied).

The Court below also noted in its opinion Petitioner's Brief A11 n.4 an appellate decision where it was found to be error for a trial court not to find a motion for leave to amend where none was formally requested *Sherman v. Hallbauer* 455 F.2d 1236 (5th Cir. 1972) accord *A/S Hydraulico Works v. Ft. Worth D. RY Co.* 483 F.Supp. 518, 521f (S.D. TEX., 1980).

Rich cites only one case in support of its argument that a grave departure from judicial procedure was committed. However, a thorough reading of that case, *Walton v. Morgan Stanley and Co.*, 623 F.2d 796 (2nd

Cir. 1980) provides additional support for the position by the court below. The Second Circuit in *Walton* did not deny that the trial court had authority to grant leave *sua sponte*. Judge Lumbard simply stated in the majority opinion that he saw no reason for the circuit Court to grant such *sua sponte* leave as suggested in the dissenting opinion. *Ibid.* 799-800 n.7. The underlying assumption in *Walton* is that the court had the unquestioned authority to allow for amendment even when none was requested in the interest of resolution on the merits.

CONCLUSION

For the foregoing reasons, a writ of certiorari should be denied and the judgment of the United States Court of Appeals for Third Circuit in these proceedings should stand.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that three copies of the foregoing were mailed, first-class postage prepaid, to Lawrence Gochberg, Esq. One Landmark Square, Stamford, Connecticut 06901 the ———— day of February, 1982.

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Attorney